IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 16995

LOS ANGELES TRUST DEED & MORTGAGE EXCHANGE,
TRUST DEED & MORTGAGE EXCHANGE,
TRUST DEED & MORTGAGE MARKETS,
DAVID FARRELL,
OLIVER J. FARRELL,
ROY A. BONNER,
THOMAS WOLFE, Jr. and
STANLEY C. MARKS,
Appellants,

v.

SECURITIES AND EXCHANGE COMMISSION,
Appellee.

Appeal from a Judgment and Order of The
United States District Court for the
Southern District of California

FILED
SEP - 6 1960
FRANK H. SCHMID, CLERK

BRIEF OF SECURITIES AND EXCHANGE COMMISSION, APPELLEE

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TD Los Angeles Trust Deed & Mortgage Exchange

&ME Trust Deed & Mortgage Exchange

&MM Trust Deed & Mortgage Markets

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Tm __ Section 1 — June 9, 10, 11, 22, 1959,— followed by page number.

Tm __ Section 2 — September 9, 1959, — followed by page number.

Tm __ Section 3 — September 15, 1959, — followed by page number.

__ Reporter's transcript of trial proceedings — October 6, 1959—May 19, 1960, — followed by page number.

__ Record designated by appellants, followed by page number.

__ Record designated by Commission, followed by page number.

__ Commission's exhibits, followed by exhibit number.

__ Appellants' exhibits, followed by exhibit letter.

__ (light green) Brief of appellants LATD, TD&MM, Oliver J. Farrell, Roy A. Bonner, Thomas Wolfe, Jr. and Stanley C. Marks, followed by page number or reference to appendix therein.

__ (dark green) Brief of appellants TD&ME and David Farrell, followed by page number.

__ 1 __ District Court's Findings of Fact and Conclusions of Law, indicating page and line number.

__ 1 __ Judgment, indicating page and line number.

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

LS ANGELES TRUST DEED & MORTGAGE EXCHANGE, :
IUST DEED & MORTGAGE EXCHANGE, TRUST DEED &
MRTGAGE MARKETS, DAVID FARRELL, OLIVER J. :
FRRELL, ROY A. BONNER, THOMAS WOLFE, JR. and
SANLEY C. MARKS, :

Appellants :

v. : No. 16995

SCURITIES AND EXCHANGE COMMISSION, :

Appellee :

Appeal from a Judgment and Order of the
United States District Court for the
Southern District of California

BRIEF OF SECURITIES AND EXCHANGE COMMISSION
APPELLEE

STATEMENT OF THE CASE

. <u>The Briefs on This Appeal</u>.

Since the Findings of Fact and Conclusions of Law of the istrict Court have been separately printed, throughout this brief e often refer to specific portions thereof rather than repeat the ame matters here. In this manner we have been able to meet the ccelerated time schedule set by this Court and we have also been ble to eliminate a substantial amount of duplication in the materials

that we assume this Court will wish to read. We have nevertheless had to seek permission to file a brief in excess of the maximum authorized by this Court's rules.[1/]

The length of this brief results largely from the manner in which the appellants have presented their case. Despite the fact that the interests of all the appellants in this litigation are substantially identical, because individual parties have separate attorneys who did not join in a single brief we are required to answer briefs totalling 123 pages, without reference to appendices thereto which contain at least an additional ten pages of argument (LG App. VII and XI). In addition to what we consider to be the essential issues involved, appellants have sought to introduce issues which we believe are not properly in the case, but to which we must nevertheless respond if only to show their irrelevance. They have also made numerous contentions of alleged procedural errors arising in connection with the extended trial in the court below; these have required detailed refutation to prove that they are without substance.

B. The Pleadings.

The pleadings are contained in R 12-52. They are summarized in the District Court's findings (F 1-3). We note here merely that this action was filed by the Securities and Exchange Commission on March 24, 1958, in the United States District Court for the Southern District of California, Central Division. The complaint, as amended on October 8, 1958, sought to enjoin the appellants from violating the registration

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1/ This was granted by order dated September 2, 1960.

Sections 5(a) and (c), 15 U.S.C. 77e(a) and (c) and anti-fraud (Sections 7()(2) and (3), 15 U.S.C. 77q(a)(2) and (3)) provisions of the Securities ct of 1933, in the sale of securities issued in connection with an nvstment plan described by the appellants as the Secured 10% Earnings rcram and variations thereof. The amended complaint also sought to nin the three corporate appellants from violating anti-fraud (Section 5()(1), 15 U.S.C. 78o(c)(1)) and broker-dealer registration (Section 5(), 15 U.S.C. 78o(a)) provisions of the Securities Exchange Act of 93, in connection with the same investment program. In addition, the mded complaint sought appointment of a receiver for the corporate ppllants.

The amended complaint alleged that the District Court had jurisiction under Section 22(a) of the Securities Act of 1933, 15 U.S.C. 77v(a), n Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. 78aa.

. The Statutes Involved.

The Securities Act of 1933 was enacted, as stated in its full ile, "to provide full and fair disclosure of the character of securiis sold in interstate and foreign commerce and through the mails and oprevent fraud in the sale thereof. . ."

Section 2(1) of the Securities Act defines a "security."

Section 5 of the Securities Act makes it unlawful to offer securiis for sale by means of interstate media or the mails unless a registrtion statement with respect thereto has been filed with this Commission. cedule A to the Securities Act sets forth comprehensive requirements wih respect to disclosures regarding the issuer and the security involved

which must be included in the registration statement. Section 7 of the Securities Act authorizes the Commission by rule to provide that certain of this information not be included where unnecessary and to require that other appropriate information be included. Sections 5 and 10 of the Securities Act require that a prospectus containing much of the informati filed in the registration statement be supplied to each purchaser. Secti 3 and 4 of the Securities Act contain numerous exemptions for types of securities and transactions where Congress determined that the disclosure provisions were unnecessary.

Section 17(a) of the Securities Act makes unlawful any fraudulent securities transactions where the mails and interstate media are used, and the exemptive provisions are specifically made inapplicable to such transactions.

Section 20(b) of the Securities Act authorizes the Commission to institute an injunction to enjoin acts or practices which constitute a violation of the Act, and Section 22(a) gives the United States district courts jurisdiction in such actions.

The Securities Exchange Act of 1934 was enacted primarily to regulate the markets through which securities flow. To facilitate this purpose, Section 15 of the Act provides, among other things, for the registration of brokers and dealers in securities and for regulation of their activities in order to protect the investing public. This regulation includes, inter alia, standards to insure adequate liquidity and solvency. The Securities Exchange Act also has anti-fraud provisions Sections 10(b) and 15(c). The Commission may bring an action to enjoin

ioations of this Act, Section 21(e), and the United States district outs have jurisdiction of such actions, Section 27.

Relevant provisions of these Acts and Rules thereunder are set orh in the Statutory Appendix hereto.

This Court has jurisdiction of this appeal pursuant to 28 U.S.C. 291.

. The Issues and Their Interrelationship.

In our view the basic issue in this appeal is whether the ppllants have been selling investment contracts required to be egstered under the Securities Act of 1933 (see pages 34-50, infra). e elieve that the statutory language and purpose, as interpreted by hetwo Supreme Court cases which have thoroughly analyzed the phrase inestment contract" in the context of the identical statutory roision here involved, requires an affirmative answer. These ass are Securities and Exchange Commission v. C. M. Joiner Leasing ororation, 320 U.S. 344 (1943) and Securities and Exchange Commission . . J. Howey Company, 328 U.S. 293 (1946). Despite the fact that the oier case discusses at length the manner in which the statutory rcision here involved must be interpreted, neither of appellants' rifs so much as cite that decision.

Determination of the issue whether appellants LATD, TD&ME and X&M should register as broker-dealers in securities under the Securi-.ei Exchange Act of 1934 is for the most part dependent upon the etcmination of the foregoing issue. If investment contracts are not

involved, the corporate appellants are presumably dealing in exempt securities under rules relating to registration under that Act and are not required to register as broker-dealers. Conversely, should these appellants sell investment contracts, the exemption would not be applicable and registration would be required (see pages 61-63 , infra).

On the other hand, the determination whether appellants have violated the anti-fraud provisions of the Securities Act and the Securities Exchange Act are not at all dependent upon whether an investment contract is involved. These violations can be predicated upon sales of the underlying trust deed notes (see pages 50-54 , infra). In this connection an extremely important issue from the standpoint of this Commission's ability to prosecute fraudulent sales of securities is whether, in the context of a proceeding to enjoin fraudulent sales of securities, certain statements of the appellants must not be deemed violations of the statute, even though on a less complete record and in connection with the determination whether the ancillary relief of a receiver was appropriate, this Court considered them merely "puffing." We disagree with appellants' assumption that it is the law of this case that erroneous statements which relate to the safety, income or marketability of an investment can be considered merely "puffing," in determining violations of the Securities Act (see pages 58-62 , infra).

Nor are the questions whether the court below was empowered to appoint a receiver and whether such appointment is appropriate in this case dependent upon the determination whether the appellants have

selling investment contracts. It is our contention that so long
ie district judge could properly enjoin violations of the Act, he
oul and properly did apply the ancillary remedy of receivership when
equred, as here, by the equities of the situation, including the
isrepresentations to investors as to what funds of theirs would be
el in trust, and the insolvency of appellant LATD (see pages 111-119,
nfn).

Appellants attempt to raise various other questions relating
imrily to the manner in which the proceedings were conducted in the
stict Court. We believe that our documented discussion of these
jetions will show that appellants in all respects had a fair trial
te lengthy proceedings below.

he Substantive Facts.

Under the heading "Jurisdictional Evidence," the District Court
oud (F 31-32) that the appellants had "introduced into the mails,
ndinto the channels of interstate commerce, countless thousands of
rohures and other selling literature describing the Secured 10%
arings Program, in addition to advertising their investment plan
hrugh the media of newspapers, radio and television." The Court
oud that "the true purpose of the defendants' saturation approach"
asto"condition the minds of investors, through incomplete,
mbguous, highly flamboyant, misleading, deceptive and untrue statements
f aterial facts, to rely upon certain basic misrepresentations which

mark all such advertising" — i.e., that under appellants' unique investment plan investors might "commit their savings to the defendants and be assured of safety and liquidity, while at the same time enjoying 'Secured 10% Earnings.'" It found that appellants' "brochures and other sales literature" were designed to convince prospective investors that LATD was "a long established, stable and sound financial institution of the highest integrity and standing in the financial community, to which investors, whatever their financial situation or investment needs," might "entrust their funds with absolute confidence." The Court found that appellants, "from the inception of the Secured 10% Earnings Program, have continuously misrepresented" the basic elements of "safety, yield or income, and liquidity" and that they "have, with marked success, succeeded in convincing many thousands of small investors that the Secured 10% Earnings Program constitutes a safe, secure and certain method of realizing earnings of 10%, which may be compounded monthly, and pyramided indefinitely to enormous totals, through 'continuous reinvestment.'"

The detailed findings that serve as a basis for these findings of what are essentially ultimate facts are fully set forth by the District Court and we shall not attempt to repeat them here. We do note that what appellants term their Secured 10% Earnings Program had been formulated by

ceber, 1957, and the essential elements thereof continued unchanged roughout this litigation (until this Court permitted the installation a conservator receiver pending this appeal). There were some minor d illusory modifications as to which the District Court found that he defendants have sought refuge in semantics" (F 5).[1/]

Appellants LATD and TD&ME, under the direction of appellant vi Farrell who dominated the enterprise,[2/] offered investors, on nationwide basis, "secured 10% earnings" through the purchase of scounted notes secured by trust deeds on California real estate, gether with an undertaking by LATD to "service" the trust deed te for investors by, <u>inter alia</u>, making monthly, quarterly or he periodic collections from trustors, remitting or reinvesting rnings, sending out delinquency notices and, where necessary,

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or example, after this Court's opinion at 264 F. 2d at 199, the next rochure issued by the appellants deleted the statement that "the only egal difference between a first or second deed of trust is that one as recorded prior to the other," which this Court had characterized as clear misrepresentation (264 F. 2d at 210). As found by the court elow, however, in confirmations to investors, appellants since have escribed trust deeds on unimproved land as "first trust deeds," without ver disclosing that they were subject to subordination to subsequent rust deeds given to secure construction loans in indefinite amounts (F 33).

'ATD is a California corporation with 100,000 shares outstanding, including 0,000 promotional shares issued to David Farrell, its president and chairan of the board. All of the stock of appellant TD&ME, also a California orporation, is owned by appellant David Farrell and his wife. TD&ME is national coordinator" of appellants' investment program. It grants ranchises to offer the plan to the public and receives in return 10% f the gross profits realized by its "franchised affiliates." TD&MM has ever issued stock, and until August 1, 1959, was a mere corporate shell aving neither assets nor liabilities. The individual appellants are fficers and directors of the foregoing corporations (F 4-5, 44).

carrying out foreclosure procedures.[1/] LATD's profit was to be derived from a mark-up of the discount price it paid on quantity purchases of trust deed notes over the discount price at which it sold them to investors (F 9).

Investors were assigned notes from LATD's "warehouse" or inventory, which it represented as containing "seasoned," "prime" and "trouble-free" trust deed notes which had been carefully screened and appraised (F 11). The trust deed notes were either purchased by investors outright or were bought on an installment basis (F 6, 8). Under the latter plan an investor's account was carried in debit balance, representing the difference between the purchase price of the trust deed and the amount paid in by the investor, with LATD retaining title until collections from the trustor, together with any deposits by the investor, extinguished the debit balance. Some 85% of investors' accounts were in debit balance (F 8). An investment in the program was evidenced by a portfolio containing copies of a note and a trust deed, and assignment thereof,[2/] a policy of title insurance,

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1/ An article widely circulated by appellants states that "almost no small investors . . . [have] the requisite knowledge properly to evaluate trust deeds, to prepare the necessary legal papers attendant upon their purchase, and service the trust deeds through to their maturity. These are specialized services, for the performance of which the Trust Deed & Mortgage Exchange is staffed with specialists" (PX 146, F 7-8, fn. 7).

2/ A small percentage of investors directed that title to the trust deeds be recorded in their names and that the original title instruments be delivered to them.

a engraved Certificate of Registration and Ownership, which the rtbelow found was "designed to resemble an engraved share of stock bod" (F 9-10).

A comparison of the investment program as presented in LATD's chres sent to investors with its actual operation reveals a basic lay in the promise of continuous 10% earnings. LATD's search for stdeeds at prices discounted sufficiently to enable it to obtain avrable margin of mark-up and still meet the promised "10% earnings" esarily forced it to "warehouse" highly speculative trust deeds atd for the most part against units of unimproved land (F 10-11). usnds of trust deeds introduced into investors' accounts were atd and executed by tract subdividers and developers and were urd by raw units of land; these trust deeds carried provisions for orination to construction loans and were purchased by LATD before cnstruction and, at times, in advance of the filing of a subdivision ad notice with state authorities (F 11).

To sustain the supply of trust deeds, LATD had to assume firm ments to the subdividers, not only for funds to provide scheduled te improvements to the land but also for funds to cover interest ortization of principal on the trust deeds for specified periods tie, sometimes as long as two years. LATD withheld from the pur- price of these trust deeds sums required to meet these commit- nts although it did not segregate these funds (F 12). The receiver

has indicated that LATD will be unable to meet these commitments. Thus, LATD was in effect using the funds of some investors to meet interest and amortization requirements on trust deeds sold to other investors, and to meet its commitments for "scheduled improvements" (cf. F 22 ll. 3-9). This was merely a variation of the so-called "Ponzi" scheme.

In connection with the issuance of trust deeds on proposed housing developments, David Farrell received substantial "participations" in many of the subdivisions for arranging secondary financing of the development through the purchase of trust deeds created by the subdividers and acquired by LATD with funds deposited by or collected for the accounts of investors (F 40-41).

LATD assured investors that the combined first and second trust deed liens would not exceed 85% of appraised market value (F 11-12). As shown from the table on pages 12-13 of the findings, in connection with 87 out of 88 representative trust deeds LATD did not conform to this standard and, indeed, in 56 of these the total of the two liens exceeded realistic valuation appraisals made by qualified appraisers for building and loan associations holding the first trust deeds.[1/]

1/ It was impossible, of course, for LATD to conform to its advertised standard in connection with trust deeds which were subject to *future* subordination to construction loans.

Early investors were told that their moneys were kept in a
arae trust fund and not commingled with LATD's general accounts.
ce December, 1957, however, there has been no segregation of
estors' funds from that of LATD's general accounts, despite the
t that there was no attempt to advise the countless investors
ected of this change (F 34 l. 23). All funds received from investors,
lucng collections made by LATD for them, have been commingled.

In this connection it should be noted that there was a sub-
ntil time interval, often extending into many months, before funds
rused to LATD by new investors, or additions to existing accounts,
e invested in trust deeds. This is made unmistakably clear by the
sisent and growing imbalance between inventory and investors'
e credit balances. For example, as at September 25, 1959, inventory
ted at cost (57% of which consisted of delinquent trust deeds)
ale $571,616, while investors' free credit balances totaled
.03426 (PX 42). As investors' free credit balances earned nothing
LATD and nothing for the investor, except the theoretical "10%
nings" reflected in the "estimated liquidation value" shown on a
lered summary sent monthly to each investor, until they were invested
rust deeds of whatever quality LATD succeeded in bringing into
ntory and introducing into the accounts, the end effect of such
ining and growing imbalance created a condition which made LATD's
vival dependent upon an increasing flow of new cash from inves-
s (F 22). That LATD never tabulated the "liquidation values" of
thousands of accounts of investors is convincing evidence of the

fact that appellants regarded them as sham and meaningless. By means of the condensed summary showing "estimated liquidation value" and other misleading devices the appellants successfully convinced investors that LATD was a safe, secure, solid depository of the investors' highly liquid and rapidly growing assets (F 37). This, of course, was an illusion. The truth is that the accounts of some 9,000 investors under the Secured 10% Earnings Program were dangerously balanced upon a "house of cards."

Although not specifically promising investors that it would take back defaulted trust deeds, it was LATD's policy to do so, in order to boast that no investor had ever suffered a loss. This led to LATD carrying in inventory a large quantity of unsaleable trust deeds. These were recorded on LATD's books at the inflated price at which they had been repurchased from investors. Despite the need for a greater reserve for losses, as defaulted trust deeds began to constitute a growing portion of inventory, LATD on March 31, 1959, established a new and lower reserve (F 21).

As at March 31, 1959, after necessary accounting adjustments in LATD's balance sheet, including adjustments to reduce inventory to original cost,[1/] LATD was shown to be insolvent in the bankruptcy sense by at least $176,100 (F 22).

1/ This did not include any deduction below original cost as to defaulted trust deeds in inventory as LATD's internal financial statement as at March 31, 1959 (PX 167), which was used as a basis for the adjusted balance sheet, made no segregation of current and delinquent trust deeds in inventory.

As at June 1, 1959, the defaulted trust deeds amounted to 39% inentory (F 25). By September 25, 1959, this had increased to 57%. :n he receiver took over on June 8, 1960, defaulted trust deeds con- tued 63% of inventory. Although appellants had assured investors .t ATD maintained a position of liquidity comparable to that of banks scurities brokers, in fact it failed to meet the standards of the mision's "net capital rule," considered the minimal standard of uity for brokers and dealers in securities (F 16-21).1/ Moreover, D oncealed its precarious financial condition by publishing financial teents which were in various respects misleading (F 25, 27-28).

Appellants' operations are described in appellants' briefs ɔs wholly without reference to the findings of the District Court tothe evidence. They speak lightly of three or four types of stdeeds that appellants dealt in (LG 62-63, DG 2-3), apparently cig to give the impression that a large proportion of trust deeds "n individual homes, bought on the open market" and that the aider were for the most part "on individual lots in subdivisions :h process of development" (DG 2). They indicate that the creation itroduction in the accounts of investors of the 800 identical stdeed notes executed by George C. Goheen in favor of Goheen

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1/ urther device used by LATD to create an impression of liquidity investment was the establishment of a "big board" allegedly for the marketing of trust deed notes. Investors were told that LATD perated an exchange for the marketing of these trust deed notes comparable to that maintained for trading in stocks and bonds. It was represented that the "Exchange" serves to stabilize the market price of trust deeds. David Farrell's testimony at the trial, however, contains an admission that there was no connection between the "big board" and the Secured 10% Earnings Program (: 15-16).

Construction Company, and endorsed without recourse to LATD, relating to a projected subdivision known as Cimarron-Meadows, which had no provisions for streets or other facilities, was an "isolated and exceptional transaction," subsequently rescinded as a "mistake."

The facts are to the contrary. Although earlier in its operations, a substantial percentage of trust deeds sold by LATD may have been secured by owner-occupied homes, the court below found "that for many months substantially all of the trust deeds acquired by LATD under the Secured 10% Earnings Program" related to "units of raw, vacant and unimproved land," and were "subject to subordination to construction loans of indeterminable amounts" (F 11 1. 10-14). Moreover, Cimarron-Meadows described above was neither an isolated nor exceptional situation. The exact format had been followed somewhat earlier by David Farrell and George C. Goheen, as joint venturers, in creating and introducing into the accounts of investors a group of trust deed notes in connection with a projected subdivision known as Scott-Highlands situated in Marin County, California. In September, 1958, 320 identical trust deed notes, each in the amount of $1,000, were created without reference to a subdivision map against 320 contiguous rectangular units of vacant land. The 320 trust deed notes were acquired by LATD, and introduced at once into the accounts of investors. This earlier arrangement has not been rescinded, perhaps because, unlike the Cimarron-Meadows situation, it had not been discovered by the California Commissioner of Corporations (Tr. 1973-1990, PX 118).

Similarly, 200 identical trust deed notes, each in the amount $,342.86, executed by Reedlands, Inc., were created against 200 ntguous rectangular units of vacant land comprising 108 acres in an easituated in Marin County, California, and were acquired by LATD d mmediately introduced into the accounts of investors. The 200 us deeds were created without reference to a subdivision map. A te preliminary subdivision map divided the 108 acre tract into 8 uilding units (Tr. 2057-2065, PX 125, 126).

As indicated above, the facts about the operation of LATD are llydetailed in the findings to which we respectfully refer the urt Specific references thereto are contained in Points II, III 1 V, infra. Appellants' challenges to the Court's findings con- st ssentially of assertions that no investor testified to having en efrauded.[1] But appellants' representations were made in bro- ure sent out to tens of thousands of investors from whom the erial facts about appellants were withheld. Moreover, purchasers e ent misleading monthly statements of their accounts (F 37), l apellants' substitution of current trust deeds for those in aut prevented investors from learning of the ever growing danger lcs of the funds which they had entrusted to LATD. Appellants' ga "No Secured 10% Earnings Account Holder has ever Sustained a s. would have been much closer to the truth if it had been confined relized losses.

1/ nere was testimony, however, to misstatements made to a prospective nvestor who refused to invest after learning of the instant law uit (Tr. 153, 156-157).

F. <u>The Proceedings to Date.</u>

The District Court's findings summarize the proceedings prior to the filing of the instant appeal (F 3-4). At this point we call attention only to the fact that, after this Court's reversal on February 1, 1959, of the District Court's order granting a preliminary injunction and appointing a receiver, various motions were made prior to the actual trial, which began on October 6, 1959. There were 36 actual trial days; 220 exhibits were introduced; and the transcript covers 3,581 pages. Because lengthy adjournments were required the trial was not ended until May 3, 1960. The Findings of Fact and Conclusions of Law and the Final Judgment of Permanent Injunction and Order of Appointing Receiver were entered May 20, 1960.

On the same date the District Court, in keeping with the suggestion previously made by this Court, stayed its judgment and order until June 7, 1960. This Court, after hearing oral argument on June 6, 1960, continued the stay on June 7, 1960, except with respect to the appointment of a receiver, although it suspended the receiver's power "to accomplish the orderly liquidation of Los Angeles Trust Deed & Mortgage Exchange and Trust Deed and Mortgage Markets," which had been ordered by the District Court. Accordingly the receiver has qualified and taken possession of these corporations. He has also employed an accounting firm to conduct an examination of the books and records of this company.

SUMMARY OF ARGUMENT

Contrary to suggestions in appellants' briefs, this Commission
nt attempting to regulate the home-owner's loan business. It is
rely seeking to enforce in a civil action statutory provisions
signed to enable investors to be fully informed about securities
ffered to them and to prevent fraud in the sale of securities.

Appellants offered on a nationwide basis a Secured 10% Earnings
ogram under which they selected trust deeds for investors, made
llections, received the proceeds, substituted other trust deeds or
reclosed in the event of default, and promised investors 10% earnings
or the first of the month in which their money was deposited whether
ot the money was as yet invested in a trust deed. In so doing,
pelants were offering investment contracts, which are specifically
fined by statute as securities, and investors were entitled to the
otections afforded by the Securities Act through registration of these
vestment contracts.

In the Joiner and Howey cases, the Supreme Court, in considering
e term "investment contract" within the meaning of the Securities Act,
ad clear that it is to be interpreted so that "the reach of the Act"
ll include "novel . . . devices," so that form will be "disregarded
r substance" "to afford the investing public a full measure of pro-
ecion," and held that offerings are to "be judged as being what they

are represented to be." It also made clear that the interests of the various investors in an enterprise do not have to be identical — indeed, in both these cases the investors received interests in different pieces of real estate. The Court held that the test is rather whether persons contribute capital to an enterprise in the expectation of receiving profits through the efforts of the promoter. Accordingly, the District Court properly found the appellants here were selling an investment contract.

The extent of the common enterprise in the instant case is emphasized by the facts developed at the trial which disclosed that most of the trust deeds sold to investors were created on hundreds or thousand of lots within the same unimproved subdivisions and that LATD withheld from the purchase price money to cover not only scheduled improvements but also to pay out interest and amortization requirements for substantia periods. In one instance 431 second trust deed notes were all subject to the same blanket first trust deed.

The court below also found, as charged in the complaint, numerous instances of fraud by appellants in the sale of securities particularly with respect to the safety, earnings and negotiability of securities offered. In view of the perilous financial condition of the corporate appellants and the irresponsibility of their management, as shown in the record below, it is clear that all such representations were properly found to have violated the anti-fraud provisions of the Securities Act. Even if this Court should disagree with the District Court's conclusion

at ppellants were selling investment contracts, these anti-fraud pro-
sics are applicable, since appellants were in any event selling notes,
ich are specifically defined as securities. Although these may fall
thi certain exemptions from the registration provisions of the
curties Act, they are nevertheless subject to the anti-fraud pro-
sids. Appellants' arguments that these "notes" are not securities
e ivolous.

Since the corporate appellants are selling investment contracts
d e not merely selling the underlying trust deed notes, they come
thi the definition of securities dealers and cannot claim the exemption
om egistration provided for persons who deal solely in individual trust
ed otes secured by whole mortgages. They are thus also in violation of
ti raud provisions applicable to securities dealers.

Appellants had a fair trial. An examination of the court's
lings in the light of appellants' obstructive tactics makes clear that
e istrict judge fully complied with all procedural rules and the require-
nt of due process. Nor is there any merit to appellants' charges of
prooriety by either Commission counsel or the Court.

The judgment appealed from properly and clearly sets forth appel-
nt' violations. The findings below and the decree correctly enjoined
ntnued violations. The Court had jurisdiction to appoint a receiver
prt of its inherent equity powers and it properly did so in view of
pelants' insolvency and its misapplication of investors' funds.

ARGUMENT

I. THE APPELLANTS' BRIEFS ARE PREDICATED ON BASIC MISCONCEPTIONS.

Throughout the appellants' briefs run two basic assumptions: (1) that the Commission is seeking to regulate the home-owner's loan business, and (2) that the Commission's action is penal in nature. Both assumptions are wholly erroneous.

A. This Commission Is Not Attempting to Regulate the Home-owner's Loan Business.

Appellant's principal arguments on the merits resolve themselves into the following propositions: (a) appellants are simply engaged in buying and selling individual mortgages and deeds of trust, primarily created by individual homeowners in connection with their purchase of a home (DG 2-5); (b) mortgages and deeds of trust are not securities (DG 6); and (c) the Commission is adopting a contrary position and thereby asserting a general regulatory jurisdiction over the mortgage and home finance field which Congress has confided to other agencies and which the Commission is not authorized to invade (DG 6, 16, 18, 28-33).

This approach misstates the record, confuses the issues and misconstrues the Commission's position. In fact: (a) appellants are offering and selling not merely individual trust deeds but rather a comprehensive investment plan which they describe as the "Secured 10% Earnings Program." As we show under Part II, *infra*, this embodies an investment contract; (b) whether or not a mortgage or deed of trust,

sicred as a lien on a parcel of real estate to secure an obligation,
a scurity, the promissory notes secured by such lien, which appel-
ts also offer and sell, are certainly securities within the plain
guge of the statutes (see Point III, infra); and (c) the Commission
ben careful to avoid any unnecessary intrusion into the home loan
ld and is here merely discharging its statutory duty to restrain the
lic sale of unregistered investment contracts; to restrain the
erng and sale of such investment contracts and of promissory notes
fradulent means; to restrain appellants from dealing in such investment
trcts in interstate commerce without registration as a dealer, and,
ilary to the foregoing, invoking the equitable jurisdiction of the
rt to appoint a receiver.

It is ironic that appellants seize upon regulations of the Com-
sin designed to avoid unnecessary interference with home financing
support their position (DG 13-15). These regulations exempt from
istration requirements under the Securities Act and the Securities
hage Act certain promissory notes secured by liens on real estate.
y, of course, provide no exemption for fraud, nor do they extend to
esment contracts.

Appellants' argument on this point is difficult to understand,
cethe regulations in question do not deal with mortgages or trust
dsas such, but rather exempt certain promissory notes, and appellants
eflly fail to mention the fact that they sell promissory notes as

well as the trust deeds which secure them. Their conclusion, however, seems to be that an unsecured note is a note and a security, a secured note is likewise a note and a security if several notes are secured by the same mortgage, but a secured note is not a note or a security if the mortgage secures only that note. This peculiar result finds no support in the statutory definitions or the Commission's regulations. 1/ These regulations must be considered in their statutory setting. An offering of an individual secured promissory note would ordinarily be exempt from registration under the Securities Act pursuant to Section 4(1) or Section 3(a)(11) of that Act. Where, however, a number of notes are offered, these exemptions may be unavailable, and accordingly a conditional exemption is provided by Regulation A-R cited by appellants. No statutory exemption from registration as a broker-dealer is necessarily available to real estate dealers buying and selling individual promissory notes secured by mortgages and deeds of trust and the Commission has therefore provided such an exemption in Rule 15a-1. By reason of these statutory provisions and rules, the vast majority of home mortgage transactions occur without any question of registration under either the

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1/ Cf. 1 U.S.C. 1:

> "In determining the meaning of any Act of Congress, unless the context indicates otherwise --
>
> "words importing the singular include and apply to several persons, parties, or things;
>
> "words importing the plural include the singular; . . . .

The quoted statutory provision is a direct and complete answer to appellants' argument (DG 17) based on Section 303(7) of the Trust Indenture Act of 1939 (15 U.S.C. 77ccc(7)).

urties Act and the Securities Exchange Act, and we do not seek to ang that result. In these situations lenders are generally familiar th he property involved and there is presumably little need for the otetions of registration. See Securities and Exchange Commission Raston Purina Company, 346 U.S. 119, 125 (1953), which emphasized at he construction of such statutory exemptions from registration derthe Securities Act might "turn on whether the particular class of rsos affected needs the protection of the Act."

There neither is, however, nor should there be, any such exemption r te public offering of investment contracts involving real estate tersts, nor for the fraudulent offering of real estate securities to e ivesting public. In these areas the investor is entitled to the otetion of the statutes.

The Secured 10% Earnings Program was put into operation about cemer, 1957. The appellants represented that it was the oldest l lrgest institution in the field. There is evidence that similar esof plans were originated at about the same time or earlier, but ereis no question that it is only within the past few years that the e f notes secured by trust deeds or mortgages on residential pro-ctis through extensive advertising on a national scale has become mc (F 6). Until then persons asked to lend money on residential opeties were normally acquainted with the property and the borrower d did not have to rely upon various services promised by a company erising the trust deeds or mortgages. When the Commission became

aware that something more than the usual home-owners' loans were involved, it studied the problem and determined that in many instances investment contracts subject to registration under the Securities Act were being offered. On January 31, 1958, it issued a release generally setting forth its views, which are fully in accord with the position it has subsequently taken in this litigation, and suggesting that persons engaging in this business consult with the Commission.[1] Thus, contrary to appellants' implication that for the twenty-five years of its history the Commission never contended that the sort of investment plan offered by appellants involved securities as to which registration is required (DG 25), the fact is that as soon as the problem reached substantial proportions the Commission publicly took a position in full accord with the position it now asserts.

Indeed, the appellant David Farrell and counsel for LATD attended a conference with members of the Commission's staff on December 3, 1957. A letter dated December 6, 1957 (PX 145) was directed to counsel for LATD confirming the opinion expressed by the staff to the effect that the offer and sale of securities in accordance with the Secured 10% Earnings Program required registration under the Securities Act of 1933. The letter also confirmed an opinion expressed by Commission counsel that the several brochures and newspaper and television advertisements which had been used in offering and selling the investment program included numerous untrue and seriously misleading

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1/ Securities Act Release No. 3892.

.ta:ments of material facts, and that the use of such material was in
'io ition of Section 17(a) of the Securities Act.

LATD then made an abortive attempt to file a registration state-
nen (PX 139-139A) under the Securities Act of 1933 covering the Secured
.0% Earnings Program. The registration statement was returned to LATD
ıit a letter from the Commission's staff dated January 8, 1958, which
ta:d that the registration statement did not meet the requirements of
he Act and the general rules and regulations thereunder 1/ in that,
mo: other things, it was not accompanied by the required filing fee,
he prospectus contained none of the required financial information,
nd the financial statements submitted were not in compliance with the
omission's accounting regulation. 2/ The letter also noted that the
se of the word "Exchange" in the corporate name might result in
is:presentation as to the nature of LATD's business. No further
tt:mpt was made by LATD to effect registration of the securities
it the Commission, and LATD proceeded with its interstate offering
f he Secured 10% Earnings Program.

Rgulation C (17 CFR 230.400 et seq.)

egulation S-X (17 CFR 210 et seq.).

The instant action was then begun. It became a "test case" (DG 25) because appellants had refused to accept the Commission's interpretation of the statute, as expounded in its release and as related directly to David Farrell and LATD's counsel. The complaint originally did not ask for a receiver (F 1). It charged appellants with selling investment contracts without registration under the Securities Act of 1933 and through fraudulent statements in violation of Section 17 of that Act and Section 15(c) of the Securities Exchange Act of 1934. It also charged appellants with operating as a broker-dealer without registration as required by Section 15(a) of the latter Act. When, through depositions of appellants' officials taken in the proceeding, it appeared that LATD might be insolvent and the Commission became aware of the falsity of appellants' representations to investors, that each investor's fund was held in trust until a trust deed should have been purchased for him and learned that in fact these funds were commingled with other funds of LATD and used for other purposes, the Commission's complaint was amended by adding a request for the ancillary relief of a receivership. While some companies in this field have registered with the

mision during the course of the instant litigation[1/] and others hae restricted their activities in an attempt to come within an mpton from registration, we do not dispute the fact that companies thi area other than appellants might be operating in violation of feeral securities laws. A determination by an enforcement agency as theorder in which it will take steps against alleged violators is, eve, a matter wholly within its discretion and not subject to judicial

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Inview of the repeated contention of appellants throughout the tral that no company had registered or could register investments ofthe type here involved, Commission counsel put in evidence the prspectus of Mason Mortgage and Investment Corporation (PX 171A). Ths shows an offer of "investment contracts including warranty and reurchase agreements relating to $6,000,000 offering of whole motgage notes secured by second mortgages on improved real estate." Pulic files of the Commission disclose in addition that Public Motgage Company, Inc. of Florida has registered "investment contrcts relating to an offering of $2,500,000 of whole first and seond mortgage loans secured by mortgages on real estate" (File No. 2-6145).

Apellants' argument that the Commission cannot vary the items set fcth in Schedule A (DG 16) is directly contrary to the clear language oiSection 7 of the Act. It is there specifically provided as to the irormation in Schedule A

> "that the Commission may by rules or regulations provide that any such information or document need not be included in respect of any class of issuers of securities if it finds that the requirement of such information or document is inapplicable to such class and that disclosure fully adequate for the protection of investors is otherwise required to be included within the registration statement"

ad that

> "[A]ny such registration statement shall contain such other information, and be accompanied by such other documents, as the Commission may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors."

review.[1/] Accordingly claims made by appellant as to "unequal protection" of the law (R 53, 55-56) are wholly irrelevant to the issues in this case and the court below properly refused to permit an examination of Commission employees to support such contentions, which were the only bases for their motions for discovery (cf. LG 36-39, DG 43). See e.g., Madden v. International Hod Carriers,' Building & Common Laborers' Union of America, Local No. 41, 277 F. 2d 688, 694 (C.A. 7, 1960):

> "The testimony sought to be elicited and the files and records sought to be produced by the Union through its motions, subpoenas duces tecum, and questioning were not relevant and the District Court did not err in refusing to require the Board's agents to answer the questions or produce the files and records."

See also Securities and Exchange Commission v. Scott Taylor & Company, Inc., 183 F. Supp. 904 (S.D.N.Y. 1959).

B. The Commission's Action Is Not Penal in Nature.

This is not, as appellants urge, "a criminal case, or at best, a quasi-criminal proceeding" (LG 24, 25); nor is it an action "seeking penalties and forfeitures" (DG 43). The Commission brought this action for an injunction to compel defendants to cease

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1/ See, e.g., Moog Industries, Inc. v. Federal Trade Commission, 355 U.S. 411, 413 (1958), where in referring to the Federal Trade Commission the Supreme Court stated that "the Commission alone is empowered to develop that enforcement policy best calculated to achieve the ends contemplated by Congress and to allocate its available funds and personnel in such a way as to execute its policy efficiently and economically." See also Leighton v. Securities and Exchange Commission, 221 F. 2d 91, 92 (C.A.D.C. 1955); Crooker v. Securities and Exchange Commission, 161 F. 2d 944, 949 (C.A. 1, 1947); Section 10 of the Administrative Procedure Act, 5 U.S.C. 1009.

violating the law; as such the action is specifically authorized by Section 20(b) of the Securities Act and Section 21(e) of the Securities Exchange Act. Ancillary thereto, the Commission sought a receivership when it appeared that sales were being made through fraudulent means, that the money of investors represented to be held in trust was being commingled and misused, and that LATD, the principal corporate appellant, was insolvent.

As contemplated by the above-cited sections, the Commission's action seeks to protect investors by stopping activities in violation of the federal securities laws. This is to be contrasted with other procedures contemplated by the same statutory sections, providing for the transmission by the Commission of evidence of violations to the Attorney General who is authorized to institute criminal proceedings.[1/] The statutory provisions here involved "may be the basis of either civil proceedings of a preventive or remedial nature, or a punitive proceeding, or perhaps both," as noted by the Supreme Court in Securities and Exchange Commission v. C. M. Joiner Leasing Corporation, 320 U.S. 344, 353. In that case, which was also one for an injunction, the Court stated that where "proof is offered in a civil action, as

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It may also be contrasted with the procedure in Section 32(b) of the Securities Exchange Act for forfeitures enforceable by the Attorney General.

here, a preponderance of the evidence will establish the case; if it were offered in a criminal case, it would have to meet the stricter requirement of satisfying the jury beyond reasonable doubt." Accordingly, there is no basis whatsoever for appellants' attempts here to predicate procedural errors upon the assumption that the procedures appropriate to criminal cases should have been followed by the court below. Should criminal proceedings be instituted against these appellants at some future date, they will at that time be entitled to the procedural rights of accused persons.

The fundamental proposition that this is purely a civil action is not affected by the fact that in the instant case the charges relate not only to violations of the Securities Act, as in Joiner, but also to violations of the Securities Exchange Act. It is contended that because LATD is here enjoined from engaging in business as a broker and dealer in securities without registering, as required by Section 15(b) of the Securities Exchange Act, "the injunction is a judicial booby-trap," since an injunction may be the basis of a proceeding to deny or revoke the registration of a broker or dealer (LG 19). This argument ignores the statutory requirement that the Commission, to deny or revoke a broker-dealer registration, must find after appropriate notice and opportunity for hearing "that such denial or revocation is in the public interest." In any event, it has no bearing on the essential nature of the proceeding. The Supreme Court has recently made clear that where there is a

gi.ative purpose to protect the public, "a disqualification is not

ni:ment even though it may bear harshly upon one affected." Flemming

. N:stor, 363 U.S. 603 (June 20, 1960). This was stated in upholding

st:ute which deprived aliens of Social Security benefits without

:ia when they are deported because of Communist activity. The

our there specifically adopted the following statement from a

rev ous opinion joined by four of its members (363 U.S. at 614):

> "The question in each case where unpleasant consequences are brought to bear upon an individual for prior conduct, is whether the legislative aim was to punish that individual for past activity, or whether the restriction of the individual comes about as a relevant incident to a regulation of a present situation, such as the proper qualifications for a profession." DeVeau v. Braisted, 363 U.S. 144, 160 (plurality opinion).

inc under this test a proceeding to deny or revoke registration

f abroker-dealer could not be considered criminal, a fortiori,

cort proceeding may not be considered criminal merely because

deial or revocation proceeding can be based thereon.

II. THE DISTRICT COURT CORRECTLY FOUND THAT APPELLANTS WERE ISSUING INVESTMENT CONTRACTS REQUIRED TO BE REGISTERED UNDER THE SECURITIES ACT OF 1933.

A. Investors Were Offered by Appellants an Investment Contract Within the Definition of a Security in Section 2(1) of the Securities Act of 1933.

In its opinion of February 17, 1959, this Court did not decide whether what was issued and sold by the appellants was an investment contract, but it did suggest, among other factors to be considered, (264 F. 2d at 212):

> "that a proper determination of this case required a factual finding, in the court below, as to whether there was an investment 'in a common enterprise,' and whether the purchaser 'is led to expect profits solely from the efforts of the promoter or a third party.' S.E.C. v. W. J. Howey Co., 1946, 328 U.S. 293, 298-99."

The District Court has set forth exact, factual findings, which are amply supported by the evidence, and on the basis thereof, has found "categorically that the instruments offered by the defendants [were] 'investment contracts'" (F 46 11 9-10). These findings, which are fully in accord with this Court's views expressed above, are set forth in detail at pages 44-46 of the District Court's Findings of Fact and Conclusions of Law and are a complete answer to appellants' unsupported claim that the District Court was not responsive to this Court's direction (DG 26).

In the two leading Supreme Court cases defining what constitutes an "investment contract," Securities and Exchange Commission v. Joiner

orporation, 320 U.S. 344 (1943), and Securities and Exchange Commission

v. W. J. Howey Company, 328 U.S. 293 (1946), the Court noted that:

> ". . . the reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a 'security.'" Joiner, supra, 320 U.S. at 351

nd that in construing the term

> "Form . . . [is] disregarded for substance and emphasis . . . placed upon economic reality" "so as to afford the investing public a full measure of protection. . . ." Howey, supra, 328 U.S. at 298.

As noted at page 5, supra, appellants have not cited the Joiner ase, although it is the first of only two cases in which the Supreme ourt analyzed the term "investment contract" within the meaning of the ecurities Act and it set forth the basic criteria to be followed in etermining the existence of such a security.1/ The Joiner case involved ales to widely scattered purchasers of leaseholds in specific portions f a tract of potential oil and gas land. It was represented in he selling literature that an exploratory well would be drilled by the romoter to prove the potentiality of the land. Investors were to profit y the appreciation in the value of their individual leaseholds should

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1/ Nor do appellants cite Securities and Exchange Commission v. Variable Annuity Life Insurance Company, 359 U.S. 65 (1959), the VALIC case, which held that variable annuities are securities, presumably investment contracts, within the broad definitions of Section 2(1) of the Securities Act (id. at 67, 72 and 93), although appellants seek to draw an unwarranted conclusion from language in the brief submitted by the Commission to the Court of Appeals in that case (DG 19-20).

the exploratory well prove successful; they were not to share directly in any profits from the well. The lower courts, believing that no security was involved, refused to grant an injunction at the instance of this Commission to restrain violations of Sections 5 and 17 of the Securities Act. The Supreme Court reversed, holding that the defendants were selling investment contracts as that term is used in the definition of securities in Section 2(1) of the Securities Act. It set forth as the touchstone in defining the term "investment contract" the following (320 U.S. at 352-353):

> "The test rather is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect. In the enforcement of an act such as this it is not inappropriate that promoters' offerings be judged as being what they were represented to be. [Emphasis supplied]"

What the appellants in the instant case represented they were selling in the basic sales literature was not, as appellants now contend (quoting a resolution adopted by LATD's directors on October 14, 1958, after filing of the amended complaint), mere trust deeds as to which LATD, "as an accommodation" would "if requested receive and transmit the periodic payments" thereon (DG 21). As the District Court found (F 45 11 11-18), "investors under the Secured 10% Earnings Program are 'led to expect' the promised 10% earnings solely on the basis of the continue ability of LATD to select, screen, appraise and acquire suitable trust deed notes, to service and collect the loan and, if necessary, handle foreclosure thereof, and if required by the investor, to repurchase or

rage for the resale of the obligation. There is an implied guarantee aist loss and that investors will realize a minimum of '10% earnings,' d definite commitment by the defendants to arrange for continuous irestment of the investor's funds, so that such earnings will be comunded monthly for an indefinite length of time."

In Howey, the Supreme Court reaffirmed the principle inherent iner that "investment contracts" may be created without the investors aring collectively or pro rata in the profits to be derived from the terprise. This Commission had sought to enjoin the sale of securities thout registration in violation of Section 5 of the Securities Act. eDistrict Court refused to grant the injunction, holding that no ecrities were involved, and this determination was affirmed by the ourt of Appeals.[1/] As appears from that decision, the defendants were eling individual orange tree groves and offering therewith contracts orcultivation of the land and the harvesting and sale of the produce. eific lots were deeded to the purchasers who were required to pay orreplacement of dead trees and other special services where required. eCourt of Appeals noted (151 F. 2d at 717) that "each purchaser oced for the income from his investment to the fruitage of his own

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/ Securities and Exchange Commission v. W. J. Howey Company, 151 F. 2d 714 (C.A. 5, 1945), rev'd 328 U.S. 293.

grove and not to the fruitage of the groves as a whole, and that each purchaser's income was in no sense dependent upon the purchase or development of other tracts than his own, except in the sense that as grove owners generally prospered, each owner of the grove did." It noted, moreover (Id. at 715, 716), that no one was required to accept the service contract offered by the company.

The Supreme Court reversed the determination of the Court of Appeals, holding that the defendants were selling investment contracts. It stated (328 U.S. at 299-300) that "the respondent companies are offering something more than fee simple interests in land, something different from a farm or orchard coupled with management services"; that respondents were offering an "opportunity" for profit to persons residin "in distant localities," who had neither the ability nor desire to farm the land themselves but who were "attracted solely by the prospects of a return on their investment." The Court concluded (Id. at 300):

> "Thus all the elements of a profit-seeking business venture are present here. The investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise. It follows that the arrangements whereby the investors' interests are made manifest involve investment contracts,

regardless of the legal terminology in which such contracts are clothed." 1/

Similarly, here the legal terminology is not controlling. As cart below found (F 46 11. 5-14):

"The elements that make up an 'investment contract' within the statutory definition, as distinguished from some other form of security, are not amenable to characterization in absolute terms. Consideration must be

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Bth the Howey and Joiner cases make clear that the term "investment cntract," which prior to the adoption of the Securities Act, also hd been included in the definition of security in many state blue sy laws, has continuously been utilized to encompass transactions in wich the investor looks to the efforts of the managers of the enterpise for the success of his investment. Thus in the Joiner case the Curt said (320 U.S. at 352, Note 10):

"One's cemetery lot is not ordinarily throught of as an investment and is most certainly real estate. But when such interests become the subjects of speculation in connection with the cemetery enterprise, courts have held conveyances of these lots to be securities. Matter of Waldstein, 160 Misc. 763, 291 N.Y.S. 697; Holloway v. Thompson, 42 N.E. 2d 421 (Ind. App.). For other instances where purported sales of property have been held 'investment contracts' see Securities & Exchange Comm'n. v. Crude Oil Corp., 93 F. 2d 844 (interest in oil royalties sold as bill of sale for specified number of barrels of oil); Securities & Exchange Comm'n. v. Tung Corporation, 32 F. Supp. 371; Securities & Exchange Comm'n. v. Bailey, 41 F. Supp. 647 (land bearing tung trees, to be developed by seller); Securities & Exchange Comm'n. v. Payne, 35 F. Supp. 873 (silver foxes); Prohaska v. Hemmer-Miller Development Co., 256 Ill. App. 331 (farm land, to be paid for with proceeds of crops raised by vendor); Kerst v. Nelson, 171 Minn. 191, 213 N.W. 904 (land to be cultivated as a vineyard by a third party); Stevens v. Liberty Packing Corp., 111 N.J. Eq. 61, 161 A. 193 (rabbits)."

Additional cases referred to in the Howey case (328 U.S. at 298-299) iclude Atherton v. United States (C.A. 9), 128 F. 2d 463 (oil leases); Enfield Company of California v. Securities and Exchange Commission, 13 F. 2d 746 (whisky warehouse and bottling contracts); Securities ed Exchange Commission v. Universal Service Association, 106 F. 2d 22 (farming operation); Securities and Exchange Commission v. Bourbon Sles Corporation, 47 F. Supp. 70 (barrels of whisky); Securities and Echange Commission v. Wickham, 12 F. Supp. 245 (profit sharing cntracts in commodity and security speculations); Securities and Echange Commission v. Timetrust, Inc., 28 F. Supp. 34 (individual tust agreements); and Securities and Exchange Commission v. Pyne, F. Supp. 988 (fishing boats).

> given to all surrounding and collateral arrangements. Measured by the standards enunciated in S.E.C. v. Joiner and S.E.C. v. Howey Co., the Court finds categorically that the instruments offered by the defendants are 'investment contracts.' The 'thread on which [the investors] beads are strung', S.E.C. v. Joiner Leasing Corporation, 320 U.S. 348, is the ability of the defendants to make good their representations, commitments and undertakings to investors under the Secured 10% Earnings Program, specifically, if called upon, to accomplish the liquidation of the accounts of 8000 investors at the fictitious 'liquidation values' which the defendants represent to exist."

The proceedings in the court below uncovered other aspects of appellants' enterprise which were not before this Court in the appeal from the preliminary injunction, and which even more clearly than in Howey and Joiner established that "there was an investment 'in a common enterprise.'" Cf. Los Angeles Trust Deed & Mortgage Exchange v. Securities and Exchange Commission, 264 F. 2d 199, 212. As found by the court below (F 45 ll. 36-42):

> "The community of interest which exists among investors under the Secured 10% Earnings Program is made explicit by the fact that, in accordance with the arrangements between LATD and real estate subdividers under which thousands of trust deed notes are created, brought into inventory by LATD, and introduced into the accounts of investors, LATD regularly withholds from the purchase price of the trust deed notes substantial sums of money to cover 'scheduled improvements' and to service interest requirements on the obligations for stated periods of time."

In this connection the District Court noted in its findings (F 45 ll 51-58):

> "There can be no question but that, through these and similar arrangements, LATD creates a condition under which the economic welfare of investors is dependent upon the financial resources of LATD and its ability to meet obligations which are assumed in connection with the creation of trust deeds sold to investors; and that any default by LATD would seriously

> jeopardize and impair the value of the securities sold to investors in connection with any situation where LATD has withheld or is now withholding funds to be applied to 'scheduled improvements', or to service interest requirements or amortization of principal for stated periods of time."

we have seen (page 16 , supra,) the court below found that sub-
ntially all of the trust deeds acquired by LATD in recent months
e of this sort.

An absolute community of interest existed among the investors
to whose accounts LATD introduced 431 notes aggregating $650,000,
ured by second trust deeds created against an equal number of small
ts of raw land comprising a single tract situated in Orange County,
lifornia. This tract was subject to a blanket first trust deed, in
e amount of $706,000, containing no clause under which, in event the
ustor of the first lien defaulted, the investors holding the second
ust deeds could obtain a release as to their separate units of land
advancing their pro rata share of the $706,000 obligation, although
e special forms used by LATD in confirming out the 431 trust deeds
implied. Moreover, as the first trust deed was held by an estate
en under administration, court approval would have been required
fore the terms of the lien could have been modified (F 34 11 1-15;
11, 131A).

But all aspects of LATD's Secured 10% Earnings Program evidenced
common enterprise and an expectation by investors of earnings and
owth of capital from the efforts of the managers of the enterprise.
e keystone of LATD's entire investment program was a promise of

continuous 10% earnings to investors. Earnings running from the first of the month were promised on funds deposited by the twentieth (F 37-38). Whether or not a trust deed had yet been assigned to an investor's account, LATD sent him a monthly statement containing a column labeled "Estimated Liquidation Value," which indicated earnings on deposits in the same manner for all investors, without regard to the actual cash liquidation values of their accounts. Thus the liquidation value shown in the statements sent to investors in the continuous reinvestment or growth plan always showed a monthly increase in liquidation value at the same rate, i.e., 10% per year compounded monthly. This translated into specific terms the projected growth schedule set forth in LATD's sales brochures. Where investors elected to have their "earnings" remitted monthly, they received the 10% even though they had been assigned no trust deed (F 37, ll 35-42); investors to whom a trust deed had not been assigned were necessarily being paid out of LATD's general funds. Accordingly, it was represented to thousands of investors that their accounts were experiencing a common rate of growth, evidenced by the "estimated liquidation value," and that, in effect, LATD was simply a depositary for their accounts, which would be redeemed or liquidated at any time at the stated liquidation value. LATD thus held out to each investor, in common with all others, that they might look to LATD's capital and resources in order to realize these liquidation values. The community of interest existing among all such investors in LATD's resources and its ability to meet demands for redemption, is implicit in LATD's action in establishing on a common basis, and without regard to actual realizable values, the "estimated liquidation values" and in reflecting those values in the accounts of

irestors regardless of whether they were fully invested in current st leeds yielding a full 10%, whether they held only unsatisfactory st eeds, whether they were not fully invested in trust deeds falling nir either category, or whether they were entirely uninvested in st leeds. Hence, the court below properly found "that investors who mit their funds under the Secured 10% Earnings Program are investors a common enterprise', whose economic welfare is inextricably inter-n with the ability of LATD to meet its commitments, and the value whose accounts is dependent upon the solvency and resources of LATD" 45, ll 7-11).

As in Howey and Joiner, moreover, the investor expected numerous vices to be performed for him. He was told that his trust deed had n elected in accordance with his individual investment needs and t had been screened and appraised by LATD's experts in order to minte any risk of loss. Furthermore, he was assured that LATD would fon certain services, such as making collections, reinvestment in ernotes or remittance of the proceeds and, in the event of default, sostitution of another note or the carrying out of the details of orclosure proceeding. Accordingly, the District Court properly clded that "the instruments issued in connection with the Secured Ernings Program, accompanied as they are by the defendants' services colection, screening, processing, repurchasing or reselling, in orance with the general plan of investment in the light of the repre-taions, express and implied, made by the defendants, are investment trcts within the statutory definition" (F 45, ll. 1-5).

In addition to these essential aspects of a security inherent in iterests purchased by investors from LATD, as we have noted, page 11,

supra, the evidence of assignment of a trust deed received by investors was an engraved "Certificate of Registration and Ownership", designed to look like a traditional security.

Appellants state flatly that "the purchaser of the individual mortgage is given full and complete control of the mortgage interest whi[c] he has bought" (DG 21) and, by quoting from a sales brochure revised in July, 1959, long after this action was brought (LG 66), attempt to show that its customers assumed the duties and responsibilities incidental to ownership of a trust deed, especially with respect to foreclosure of not[e] in default. The fact is, however, that LATD by holding title as trustee to many of the trust deeds 1/ and by other devices, not only controlled the trust deeds but was in a position to manipulate them at will for its own advantage and to the detriment of investors. For example, in those instances where makers liquidated their notes in advance of the maturity date, LATD utilized its controlling position to appropriate these "windf[a]ll" profits, promised to and properly belonging to its investors. 2/ As shown by the quotation from the Howey case at page 39, supra, "the legal terminology" of what the investor receives may be of little weight in determining what constitutes an investment contract; rather what investors ar[e] led to expect is important. Just as it was possible for an investor in

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1/ See page 10 of the District Court's Findings of Fact and Conclusion[s] of Law (11 9-13):

> "While all investors receive a 'Certificate of Registration and Ownership' they are encouraged to leave title to their deeds in the name of LATD as Trustee. This, of course, gives LATD full dominion over their accounts. Some 30% or 40% of investors who hold fully paid for trust deeds have acquiesced in this arrangement. LATD retains title to all trust deeds sold on installment terms."

2/ For a full description of this practice see pages 35-37 of the Dist[ri]ct Court's Findings of Fact and Conclusions of Law.

ie owey case to cultivate his own orange grove so, too, some few ivetors with LATD might not rely upon it to service their trust deeds. weer, as the District Court found (F 45 11 20-23):

> "It is evident that few of the investors, many of whom reside at great distances from the State of California, where the makers of the notes reside and where appraisals, collections and foreclosure proceedings must be carried out, have any knowledge of or, indeed, any interest in the solvency of the makers of the notes or the quality of the underlying security."

Although appellants urge that investors purchased no security ron them because single trust deeds were not split and that there as o "common interest in the same subject matter of sale" (DG 20), as e ave seen, the Howey case involved a security consisting of a deed f specific tract of land together with the offer of a service arrange- ent under which profits were on an individual basis. It was a common nterprise in the sense that the appellants here manage a common enter- rie, i.e., that the service arrangement presumably could not have ee as economically provided for an individual participant.[1/]

1/ ppellants wrote a hestitant investor:

> "Because we have accounts from all over the world and nearly every state in the union, we certainly would not expect one of our customers to have to take care of these details (i.e., reinvestment, foreclosure, etc.) himself. That is why we have this stabilization policy to provide our customers with the continuous 10% earnings and to relieve them of the responsibilities of collecting and servicing their trust deeds. We buy only trust deeds where the property owners themselves have a substantial equity. In the event of a foreclosure, we will then gain the property for our efforts." Letter of O. J. Farrell, LATD's vice-president, dated April 28, 1958 (PX 75).

Similarly, a salesman advised a prospective investor: "You have nothing to do with the mortgages" (Tr. 153).

Cf. the statement in Joiner that purchasers are not "left to their own devices for realizing upon their rights" (320 U.S. at 348).

On the basis of their misleading summary of the testimony of Mr. James West, Jr., an investor witness called by the Commission (LG 63-65), appellants contend that his testimony shows that investors in the Secured 10% Earnings Program were not involved in a common enterprise and did not rely upon the services of LATD. Mr. West rejected several trust deeds offered to him (LG 65, DG 27). A fair reading of Mr. West's testimony discloses, however, that a reason for his rejection of these trust deeds was his awareness of the extent to which his interest would be bound together with others, especially in the foreclosure of trust deeds secured by raw acreage. Mr. West stated to LATD:

> "'Suppose I have to go through foreclosure and everything, what am I going to foreclose on? The only thing I can do is drop it back into your lap and let you foreclose with a hundred other people here.' I said, 'This is too nebulous for me. It is beyond my comprehension.' I said, 'I can't take that.' (Tr. 242)
>
> * * *
>
> Well, I knew where the property was, and again it was one of these deals that were divided on paper, and first of all I didn't like the set-up on the thing. I like a legal description of the thing, where I have egress and ingress. I want one lot where I can control the foreclosure. I don't want to fall back on somebody else. I like to control it myself." (Tr. 243-244).

As we have noted in Point I, supra, the main theme of appellants' arguments is that this Commission is seeking to expand its jurisdiction into the real estate field. Similar arguments have been made with respect to this Commission and state blue sky commissions whenever they have refused to be governed in their administrative duties by form rather

an y substance. In response to such an argument in the Joiner case

e Spreme Court stated (320 U.S. at 352):

> "Nor can we agree with the court below that defendants' offerings were beyond the scope of the Act because they offered leases and assignments which under Texas law conveyed interests in real estate. In applying acts of this general purpose, the courts have not been guided by the nature of the assets back of a particular document or offering." (Footnotes omitted).

e Spreme Court there emphasized (320 U.S. at 350-351) that the

nerlly expressed legislative policy of the Securities Act, which is

becarried out in particular cases, is to provide full disclosure

pesons offered an opportunity to profit through investment of their

pitl.

To make an informed decision whether to invest under the Secured

% Ernings Program investors needed truthful and complete information

ncening LATD's financial condition, including the method of estab-

shig and maintaining contingency reserves and its experience with

liruent trust deeds, the categories of trust deeds which were created

d itroduced into their accounts, the speculative quality of such trust

eds the policies followed in determining minimum underlying equities,

e tue effect of the continuous reinvestment plan, the participations

maagement in real estate subdivisions financed with funds deposited

ivestors, and many other material facts which would have been

disclosed through registration. It was, in fact, the failure of sellers of securities adequately to disclose information of this same type which led to the enactment of the Securities Act.[1/]

Appellants themselves have recognized the need for regulation as securities of the investments they offer. In opposing regulation of the Secured 10% Earnings Program by the California Commissioner of Real Estate, counsel for appellants stated on February 8, 1960, that the public needs "something other than the type of control that is implicit with the Real Estate Commission" and that "if a person wants to go out and buy an existing trust deed, the transaction has many more of the characteristics of a security. He wants to invest in something and, for that reason, he is not involved -- he does not want to get involved in the mechanics of the real estate operation but he wants to invest in something that is comparable to a security" (Tr. 2355, 2356).

1/ "During the postwar (World War I) decade some 50 billions of new securities were floated in the United States. Fully half or $25,000,000,000 worth of securities floated during this period have been proved to be worthless. These cold figures spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years of effort, in these worthless securities. The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealings that should be basic to the encouragement of investment in any enterprise. Alluring promises of easy wealth were freely made with little or no attempt to bring to the investor's attention those facts essential to estimating the worth of any security. High pressure salesmanship rather than careful counsel was the rule in this most dangerous of enterprises." House Report No. 85, p. 2, 73rd Cong., 1st Sess.

N Exemption From Registration Is Available.

Appellants' contentions that the securities they sell are exempt om egistration are, as the District Court concluded, "entirely without rit" (F 28, I 61). Appellants refer (LG 15-16) primarily to the trust ed notes in this connection but it is the investment contracts that we ntend require registration. In any event the burden of proof falls on the claimant of any such exemption. Securities and Exchange Commission . Raston Purina Company, 346 U.S. 119, 126 (1953). This holding involved e of the two exemptions from registration on which appellants rely, i.e., e so-called "private offering exemption" contained in Section 4(1) of e Act. The fact that the investment contracts were publicly advertised r sale in newspapers of general circulation and on television and radio ke any reliance on this exemption completely frivolous.

Similarly, any reliance upon the exemption provided by Section (a)11) of the Act, the "intrastate exemption," is also without ri. There was no question that until August, 1959, LATD's offer of cuities was nationwide and extended into foreign countries. As cetly noted by the Court of Appeals for the First Circuit in llborough Investment Corporation v. Securities and Exchange Commission, '6 . 2d 665, 668 (C.A. 1, 1960):

> "An issuer that has lost the exemption as to one issue of securities by a non-resident sale, does not have the opportunity to regain the legal use of interstate facilities or the mails by halting the non-resident sales and confining itself to sales to residents."

e ourt there also held that the exemption could not be regained by an ttempt to do indirectly what the statutory provisions do not allow."

Factually, moreover, as found by the District Court, although LATD about August 1, 1959, belatedly "attempted to 'spin-off' hundreds of accounts of investors under the Secured 10% Earnings Program who were non-residents of the State of California by transferring those accounts to TD&MM, a dormant shell of a corporation, and thereafter confining the offering by LATD to residents of California" (F 30 11 17-20), "not all such investors were amenable to the new arrangement" (F 30 11 37-38). Furthermore, as the District Court noted, for all practical purposes TD&MM "is now and has been at all times a mere department of LATD" (F 30 11 32-33). For a more extensive discussion of appellants' affirmative defenses, we refer to Section VIII of the findings (F 28-31).

III. THE FINDINGS OF FRAUD IN VIOLATION OF SECTION 17(a) OF THE SECURITIES ACT AND SECTION 15(c)(1) OF THE SECURITIES EXCHANGE ACT WERE FULLY JUSTIFIED BY THE EVIDENCE.

The sales by appellants of investment contracts under the Secured 10% Earnings Program are subject not only to the registration requirements of the Securities Act of 1933, but are also subject to the fraud provisions contained in Section 17(a) of the Act. See Statutory Appendix page A3, *infra*.

In addition, and even assuming appellants were not issuing investment contracts, appellants are none the less subject to Section 17(a) of the Securities Act in that they are selling the underlying notes that are secured by first or second trust deeds. We do

co:end that all of the trust deed notes sold by appellants, as
:ingished from the investment contracts of which they form a part,
necessarily subject to registration,[1] but we do contend that there
be no serious question that they are securities. The exemptions
registration do not in any way limit the application of the anti-
d provisions contained in Section 17 of the Securities Act, which
isins apply to the "offer or sale of any securities" where the mails
ntestate media are used. Although Section 3 of the Securities Act in
s exempts various classes of securities from "the provisions of this
e," Section 17(c) specifically states: "The exemptions provided in
tion 3 shall not apply to the provisions of this section" The
nptons of Section 4 are specifically limited, in the initial clause
reo, to the "provisions of section 5," i.e., the registration pro-
ion. Accordingly, appellants cannot and do not contend that Section 17
notapplicable to the sale of any security.

Appellants, however, do argue that the notes they sell are not
urities (LG 58, 59-60; DG 13) -- an argument which we believe wholly
volus in view of the express statutory definition, the documents
olvd, and appellants' own previous admissions.

See pages 23-25, supra.

We note, however, that a public offering of a series of notes identical or substantially identical in terms and secured by trust deeds created against units of land within a subdivision or projected subdivision as a means of financing the development (such as those sold by appellants — see Point II, supra) might require registration even if they were not investment contracts within the statutory deinition.

A. <u>The Trust Deed Notes Are Securities Subject to the Anti-Fraud Provisions of Section 17(a) of the Securities Act of 1933 and Section 15(c)(1) of the Securities Exchange Act and Rule 15c1-2 Thereunder</u>.

In the definition of a "security," section 2(1) of the Securiti Act specifically includes "any note" and any "evidence of indebtedness. In stating the criteria determining whether an instrument falls within one of the "general descriptive designations" of a security, the Suprem Court in <u>Joiner</u>, <u>supra</u>, pointed out with respect to the "more specific ones" (320 U.S. at 351):

> "Instruments may be included within any of these definitions, as matter of law, if on their face they answer to the name or description."

In <u>Llanos</u> v. <u>United States</u>, 206 F. 2d 852, 854 (1953) <u>certiorari</u> <u>deniec</u> 346 U.S. 923, this Court held that cases holding "that promissory notes were not 'securities' under other statutes" are not applicable to the Securities Act, where "Congress intended to include all interstate transactions which were the legitimate subject of its regulation."

We respectfully direct this Court's attention to the notes themselves (see <u>e.g</u>. PX 119), which are in form typical promissory notes that defy characterization other than as "notes" or "evidences of indebtedness." We also call attention to appellants' brochures, which emphasize the appellants are selling "negotiable notes" (PX 30-33). As we have seen (page 36, <u>supra</u>) the Supreme Court in <u>Joiner</u> has stated (320 U.S. at 353) that "it is not inappropriate that promoters' offerirs be judged as being what they were represented to be."

We have also seen (page 24, supra) that the fact that the notes ssued in connection with a mortgage makes them no less "notes" thn the definition of Section 2(1) of the Securities Act. The appel-nt contend that under the California Code of Civil Procedure the maker apurchase money note is not subject to personal liability for any fiiency between the amount received upon foreclosure and the unpaid inipal balance and that, therefore, the note becomes merely a charge len against the land (LG 59-60), and is not a true note or evidence idebtedness within the statutory definition. As this Court noted, weer, on the appeal from the preliminary injunction in this case rrspective of what a purchase price note secured by a second trust edmay be under California law" the tests set forth in Joiner must be ntolling. 264 F. 2d at 211. [1/] Assuming, moreover, that appellants' itepretation of state law is correct, [2/] the trust deed notes were vetheless enforceable evidences of indebtedness. The limitation is onthe remedy available to the holder of the notes, whose right of

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f. Securities and Exchange Commission v. Variable Annuity Life nsurance Company, supra, 359 U.S. at 69, where the Supreme Court aid:

> "In any event how the States may have ruled is not decisive. For, as we have said, the meaning of 'insurance' or 'annuity' under these Federal Acts is a federal question."

Bt see the District Court's query (F 44, fn. 21) "whether, in the ccumstances under which they have been created, thousands of the tust deed notes truly represent 'purchase money obligations' rther than instruments designed to evade applicable state usury lws. . ."

recovery is limited to the amount received through foreclosure. Many other instruments, such as mining production certificates, which by their terms are payable only from revenue, if any, derived from the production and sale of ore, and net revenue debentures are clearly securities although they, too, not only limit the remedy available to the holder, but in express terms limit the liability of the issuer.

Appellants themselves have characterized these notes as securities in a registration statement, signed by three individual appellants, which LATD attempted to file with the Commission in January 1958 (see page 27 supra). It said (PX 139-139A):

> "The securities being used in connection with this registration consist only of individual notes secured by individual deeds of trust or mortgages which are liens against real estate. No other securities or issues are contemplated."

As in Section 2(1) of the Securities Act, Section 3(a)(10) of the Securities Exchange Act defines a "security" to include "any note . . . investment contract . . ., or in general, any instrument commonly known as a security." The anti-fraud provisions of Section 15(c)(1) of the Securities Exchange Act, as implemented by the Commission's Rule 15c1-2 thereunder, are substantially similar to subdivisions (2) and (3) of Section 17(a) of the Securities Act, except that the former are limited in their application to brokers and dealers in securities (see Statutory Appendix infra A3, A6, A7). We show in in Point IV, infra that the appellant corporations are brokers and dealers in securities. Accordingly, appellants' fraudulent course of business also was in violation of Section 15(c)(1) of the Securities Exchange Act and Rule 15c1-2 thereunder.

Te Findings of Fraud by the District Court Are Fully Sustained t the Record.

The appellants, in seeking to overthrow the findings of the strict Court, have the burden of pointing out specifically where the ndings are "clearly erroneous."[1] In Glen Falls Indemnity Company United States, 229 F. 2d 370, 373 (1956), this Court said, "An appellant's mere challenge of a finding does not cast the onus of justifying on this court." The appellants however, have not made the slightest tempt to sustain their burden of establishing by a clear and conncing analysis of the evidence that the findings of the District Court e not amply sustained by the evidence. Indeed, they have done nothing re than condemn the findings in general terms.

The entirely undocumented assertion that the record contains no idence that the appellants were guilty of any fraud (LG 75) not only mpetely disregards Sections III through XII and XV of the findings te trial judge (F 5-44, 47), but also the opinion of this Court 64F. 2d 210) that "On the other side of the ledger there are some ea misrepresentations which have been made at one time or another. . ."

The findings of the court below are sustained by all the credle evidence in the record, and except for appellants' unsupported nils of wrongdoing there is little or nothing in the record to contract the specific findings of fraud which rest largely on appellants' own

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[1] ule 52(a) of the Federal Rules of Civil Procedure provides that findings of fact of the District Court shall not be set aside unless 'clearly erroneous."

records, or on admissions wrung from individual appellants called by the Commission as adverse witnesses (F 46 ll. 26-32). The absence of countervailing evidence is not due to any lack of opportunity for the appellants to make a defense. On the thirty-third day of trial, the district judge made it clear that the appellants would be allowed unlimited time within which to make their defense (Tr. 3077). The invitation was not accepted. As the District Court stated (F 46 ll. 58-62, 47 ll. 1-4):

> "The Court notes that, although near the end of SEC's case, counsel for the defendants indicated that the defense would consume about three trial weeks, except for recalling David Farrell and Stanley C. Marks for brief testimony, and the equally brief testimony of Edwin Russ, a certified public accountant, the defendants offered no defense. . . ."

To the extent that the findings of the trial court are contrary to the discredited denials made by appellants as witnesses, or where, as in connection with the findings as to LATD's lack of liquidity (F 16-1), the inadequacy of its reserve for losses (F 21), its insolvency (F 22-2, and the misleading quality and lack of integrity of its published financial statements (F 25-28), the testimony of the Commission's accounting experts is in conflict with that of the appellant Stanley C. Marks, LAT's comptroller, or the other accountant who testified for appellants (F 46 l. 61-62), and the court below resolved the conflict in favor of the Commission, the findings must be sustained. This Court has made clear that it will take the view of the evidence most favorable to the appellee who gets t

neit of all favorable inferences from the facts; it said in Joseph

Doover Company, 261 F. 2d 812, 817 (1958):

> "If each of these conclusions of law is supported by findings of fact and the findings of fact are supported by the record. . . then, unless the clearly erroneous rule applies, or the trial court has employed the wrong legal principles, we must affirm."

e ourt also said (p. 824) that, within reasonable limits, the trial

dg is entitled to disbelieve the uncontradicted testimony of a witness

ic "does not produce conviction in his mind. . ."

Appellants' briefs are so devoid of any meaningful reference to

e indings of the court below that it must be assumed that appellants

alze that the findings can neither be contradicted nor circumvented.

is Court, however, will give the findings of the District Court "great

igt" as a judicial distillation of the evidence on which the decree

bsed. Los Angeles Trust Deed & Mortgage Exchange v. Securities and

chnge Commission, 264 F. 2d 199, 208.

The appellants choose to ignore, too, the admission made in the

our below by then associate counsel for TD&ME and David Farrell,[1] in

poing the appointment of a receiver, while tacitly conceding the need

r n injunction (Tr. 3612-3613):

> "MR. RYAN: Well, that is the type of a case that is the exception to the insolvency. Now, we don't have that here. Your Honor, there has been no proof that anybody has gone in and stole[n] these funds. There has been proof about misrepresentation, if the court believes the evidence, and I accept that type of thing. I am not going to

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/ . Bentley Ryan, Esq., who does not appear as counsel for appellants n this appeal.

try to argue those points. And there [have] been a lot [of] dealings that weren't right and it has been this, that and the other thing, but the court is going to say in whatever findings that it finally approves and in the judgment that it approves, 'Look, don't do that, that is out, this is out, the other thing is out,' and going down the line of those type of business practices that have been deceiving the public or could deceive the public, that have been anything that the court finds as improper with relation to the sale of these 'securities'." (Emphasis supplied.)

We make no attempt to restate the elaborate findings of fraud and deceit made by the court below. These findings substantiate all the allegations of fraud in the amended complaint. See Appendix Re Findings of Fraud at A15. We also note that the final decree specifies that the appellants are enjoined from engaging in a course of business involving fraud and deceit upon investors under the Secured 10% Earnings Program, clearly marked out in the amended complaint and sustained by the evidenc. There was no substantial variation between the allegations made in the amended complaint and the evidence adduced at the trial. Consequently, there was no reason for the Commission to seek a further amendment to c to the evidence, as appellants suggest might have been done (LG 23-24).

C. None of the Misrepresentations Made by Appellants Fall Within Any Category of Harmless "Puffing."

On the prior appeal, this Court found that some of appellants' representations to investors were "untrue, deceptive and misleading," but viewed them as falling short of "conclusively establish[ing] the allegations of fraud and deceit" (264 F. 2d at 210).[1/] The instant recor

1/ Appellants circulated a distorted summary of this Court's prior opi in its March 1959 issue of Trust Deed Topics (PX 91). This appears be the only allusion to this lawsuit in any of appellants' sales literature.

idcing appellants' inability to fulfill their promises of continuous ernings, their departure into speculative real estate promotions nared with investors' funds, and the continuing insolvency of LATD and &MM fully justifies the finding of the District Court (F 33 ll. 1-10) at, although "it is impossible in each instance to arrive at an abso-te letermination of the oftentimes thin dividing line between mere uffing' and outright deceit and misrepresentation, and to effect an solute segregation of the one from the other," the "objectionable atements are so intertwined with other definite and intentional misre-esentations that, when used in an offering of . . . the Secured 10% rnings Program, in the light of the extensive conditioning of the minds investors to regard [it] as an entirely safe, secure, solid and stable vestment medium, such statements are materially misleading."

In other words, representations characterized as "puffing," for the urpose of determining whether a receivership was necessary in a etting wherein the complete financial situation of LATD and TD&MM was t ully apparent, must be considered as violations of the fraud pro-sions of the securities acts against the background of insolvency and reponsible management disclosed by the present record. For example, ner appellants were distributing a return of capital to investors as earings," the representation of "highest return obtainable with full otection and security" — a representation that goes to the very ssece of the security — clearly falls within the non-permissible type f "uffing" characterized by Judge Learned Hand as the ". . . usual oblgato of dishonest and lurid puffing, the common tactic which has so

often proved successful with guileless investors of small means. . . ."[1] Such representations bear "the badge or mark of fraud."[2]

Under the federal securities laws, which broadly prohibit in the sale of securities "any device, scheme or artifice to defraud," and obtaining money "by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made not misleading" or engaging "in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser"[3] the area of permissible "puffing," if any, is necessarily restricted. Securities are "intricate merchandise"[4] and the Securities Act was intended to add "to the ancient rule of caveat emptor, the further doctrine 'let the seller also beware.' It puts the burden of telling the whole truth on the seller."[5] The concept of "puffing" as tolerating exaggerated statements and expressions of opinion arises primarily in the sale of tangible property which is within the view of the buyer and may

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1/ United States v. Cotter, 60 F. 2d 689, 690 (C.A. 2, 1932).

2/ Henderson v. United States, 202 F. 2d 400 (C.A. 6, 1953).

3/ Section 17 of the Securities Act. And of Sections 10 and 15(c)(1) of the Securities Exchange Act and Rules thereunder.

4/ H. Rep. No. 85, 73d Cong., 1st Sess. (1933), p. 8.

5/ Id. at p. 2.

ex.ined by him. It has been indicated that it falls "under the
:tr.e of caveat emptor" and applies where it appears that examination
th articles will offset the exaggerations of the salesman.[1]
se.uently this concept of mere "puffing" can have little application
th sale of securities — intangibles whose purchase is based, at
t, wholly upon an opinion or judgment as to their safety, earnings
f.ture value, and this is particularly so in the construction of a
ed.l statute enacted for the protection of investors.[2]

The courts have recognized that securities transactions, unlike
ta. other forms of merchandising, are amenable to the more subtle
i.tangible varieties of deceit and have extended the protection
or.d investors under the federal securities acts. See e.g., Norris &
sh.rg v. Securities and Exchange Commission, 177 F. 2d 228, 233 (C.A.D.C.,
9)

> ". . . it has long been recognized by the federal courts that the investing and usually naive public needs special protection in this specialized field." (Emphasis added.)

Ar.er v. Securities and Exchange Commission, 133 F. 2d 795, 803 (C.A. 8,
3) certiorari denied 319 U.S. 767, the Court said: "The business of
di.g in securities is one in which opportunities for dishonesty are of

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P.ople v. Davis, 112 Cal. App. 2d 286, 246 P. 2d 160, 168 (1952);
C.eetham v. Ferreira, 73 R.I., 425, 56 A. 2d 861, 863 (1948).

C. United States v. Whitmore, 97 F. Supp. 733 (S.D. Cal., 1951) where
te court held that "puffing" "which is tolerated in the law of civil
lability" nevertheless may be a basis for criminal prosecution under
te mail fraud statute.

constant recurrence and ever present. It engages acute, active minds, trained to quick apprehension, decision and action."; and in Hughes v. Securities and Exchange Commission, 174 F. 2d 969 (C.A.D.C., 1949), it was stated:

> "It cannot now be doubted that . . . the securities field, by its nature, requires specialized and unique legal treatment. This is recognized by the very statutes and regulations here under consideration (§ 17(a) of the Securities Act of 1933, §§ 10(b) and 15(c)(1) of the Securities Exchange Act of 1934), as well as by recent federal and state court decisions."

IV. THE DISTRICT COURT PROPERLY ENJOINED LATD, TD&ME AND TD&MM FROM ENGAGING IN BUSINESS AS BROKERS AND DEALERS WITHOUT REGISTRATION UNDER THE SECURITIES EXCHANGE ACT OF 1934.

The District Court, having found that LATD, TD&ME and TD&MM were selling securities in the form of investment contracts, as defined in Section 2(1) of the Securities Act as well as in Section 3(a)(10) of the Securities Exchange Act, properly enjoined the appellants from using the mails or instrumentalities of interstate commerce to engage in business as brokers or dealers in securities without registration with the Commission, in accordance with Section 15(b) of the Securities Exchange Act. These terms generally include "any person engaged in the business of buying and selling securities for his own account." See Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act.

The appellants admittedly were engaged in the business of buying and selling trust deed notes, which as we have seen, are beyond doubt securities as defined in both the Securities Act and the Securities Exchange Act (Point III, supra).

While it is true that brokers or dealers who transact business lel in single undivided mortgage or trust deed notes are not required reister under Section 15(b) of the Securities Exchange Act, because ch ecurities are defined in Rule 15a-1 thereunder, as exempted securities, appellants are not merely dealing in notes that might fall within at efinition; they are dealing also in investment contracts issued ccnection with their Secured 10% Earnings Program, securities which e rt exempted.

Thus the corporate appellants, by arranging the Secured 10% rnigs Program so that it became a nationwide business not simply in ıstdeed notes but in investment contracts, cannot claim an exemption om egistration as brokers and dealers which otherwise might have en vailable. They became subject to registration and other requirentsintended for the benefit of the investing public flowing therefrom. r eample, registration as brokers and dealers would have made available .o the public important information concerning the organization, nagment and financial condition of the corporate appellants. As gisrants, the appellant corporations would have been subject to these les, requiring inter alia that the application for registration be pt ıp to date (Rule 15b-2, 17 C.F.R. 240.15b-2), that books and other cods be kept in a prescribed fashion and be preserved for specified rids of time (Rules 17a-3 and 17a-4, 17 C.F.R. 240.17a-3 and 4), and at annual financial reports certified by independent accountants be le (Rule 17a-5, 17 C.F.R. 240.17a-5). In addition, the books and cods of registered brokers or dealers are subject to inspection by isCommission when deemed necessary in the public interest or for the otection of investors. See Section 17(a) of the Securities Exchange Act.

V. APPELLANTS HAD A FAIR TRIAL AND THEIR PROCEDURAL OBJECTIONS ARE WITHOUT MERIT.

In connection with the pre-trial proceedings and during the course of the extended trial below the district judge acted with a scrupulous regard for the rights of the appellants. We shall show that appellants' assertions with respect to alleged procedural errors committed by the district judge are wholly without justification. These assertions can best be understood when viewed in the context of the delaying and evasive tactics practiced by appellants to prevent the District Court from having available the facts that this Court had indicated were appropriate to a determination of the issues herein.

A. To Conceal the Facts about their Business, Appellants Followed a Delaying and Evasive Course.

1. Appellants' conduct prior to the trial. This Court's opinion reversing the preliminary injunction stated (264 F. 2d at 207):

> "No attempt was made (nor was it possible by reason of time limitations) by SEC representatives to determine what the actual market value of the trust deed notes were, nor the actual discount at which they had been purchased, either (a) by an examination of the records to determine what discount had been involved in the specific purchases made by defendant Los Angeles Trust Deed & Mortgage Exchange, or (b) by an examination of payments theretofore made on both the first and second deeds of trust (i.e., how 'seasoned' they were), or (c) by a physical examination of the value of the security underlying the several trust deeds."

accrdance with the suggestion implicit in this quotation, n eaminations were attempted by members of the Commission's ff uring the period following this Court's denial of a petition reearing on March 30, 1959, and prior to June 9, 1959, when acion was set for trial on the merits. Thus, on April 28, 9, he Assistant Regional Administrator of the Commission's Aneles Office attempted to arrange for an inspection of LATD's ks nd records (CR 76 — Affidavit of C. R. Burr, pp. 1-2). Although nse for appellants at first indicated that such an examination ld robably be started the following week, they delayed setting ate when the examination could begin, and on May 28, 1959, ellnts' counsel categorically stated that access to any of the ks and records of LATD would be refused to the Commission. reon, the Commission served a subpoena duces tecum to take doosition of LATD's accountant. Thereafter, on June 2, 1959, ageement was made for LATD to make its books fully available ispection by the Commission's staff the following day (CR 76 - idvit of C. R. Burr, pp. 3-5). However, most of the records igh by the Commission were not made available at the time; for ampe, despite repeated requests therefor, the valuation appraisals th trust deeds and the inventory ledger and supporting records re ot produced. (CR 76 - Affidavit of R. W. Rheinschild, pp. 4-9).

Thus, the Commission was required again to serve _subpoenas duces tecum_, this time on the appellant David Farrell as president of LATD. The Commission also moved for an order requiring LATD to permit the inspection and photocopying of certain books, records and documents pursuant to Rule 34 of the Federal Rules of Civil Procedure. This motion, together with motions to quash the Commission's subpoena and other motions were heard at about the time the trial had been originally scheduled to begin. At that time appellants' counsel in urging further adjournment suggested that the trial could be shortened and made more orderly by having all facts available in advance (1 Tm. 10). The case ultimately was adjourned until October 6, 1959, after the Court on June 10, 1959, granted the Commission's discovery motion and denied appellants' motion to quash its subpoenas.

As the District Court found (F 46 _ll_. 34-38), the appellants "interposed formidable barriers" against the Commission in "refusing access to essential records, including those necessary to establish pre-trial order under Rule 34 . . .".

Beginning on June 11, 1959, the day after the order under Rule 34 was granted, and continuing intermittently through July 6, 1959, when appellants completely denied all further access to the books and records, members of the Commission's staff attempted by all

itale means to examine the records to which the District Court had antd access. Throughout the attempted examination, the appellants TD nd David Farrell and their respective counsel so interfered th nd refused access to records that the efforts of the Commission obain evidence vital to a determination of LATD's financial ndiion were obstructed and defeated. On July 6, 1959, counsel for TD rbitrarily terminated the limited and fragmentary examination ichhad been allowed. Throughout the attempted examination pursuant th order under Rule 34, members of the Commission's staff had mpled with all limitations suggested by counsel for appellants, cluing confining the hours of their work in the executive offices of TD o from 10:00 a.m. until 12:00 M. and from 2:00 p.m. to 4:00 p.m. cort hours") (PX 170 -- Affidavit of R. W. Rheinschild, pp. 3-20).

In an effort to facilitate the inspection and to secure the cesary evidence within the shortest time possible and least icovenience to appellants, the Commission, at considerable expense, id ent an accounting expert from Washington, D. C. and another omits Seattle Regional Office to augment the limited staff of its s ngeles Office engaged in the inspection. These efforts were aviling. As set forth in a schedule appended to the Commission's ibsquent motion under Rule 37(b), eighteen groups of records veed by the order under Rule 34 were refused, for one specious

reason or another, including nearly all of the records necessary for a meaningful determination of LATD's financial condition (PX 170 - Affidavit of R. W. Rheinschild, pp. 16-20). The testimony of John W. Vogel, a Commission attorney, who was present at times during the staff's attempt to examine LATD's records establishes the fact that appellants even refused to make LATD's minute book available (Tr. 1358-1361; 1380-1382).

During the testimony of Oliver J. Farrell, vice-president and director of LATD, there were introduced eight written requisitions for records of LATD, access to which was refused (Tr. pp. 1329-1398; PX 66-73).

Appellants' statements that "[w]ithin a few days, the friendly, co-operative attitude of the SEC investigators subtly changed to arrogance" (LG 41) and that "appellants confidently believed that they had generously and liberally co-operated with the discovery requirements of the SEC" (LG 42) are contrary to the record. Appellant Oliver J. Far'll testified that while the inspection under Rule 34 occasioned some inconvenience to the staff of LATD he observed not the slightest act of discourtesy and that "they have been most courteous, most pleasant, and I believe that all of our employees would concur in my thinking that there was no discourtesy . . . but that it was an imposition and inconvenience" (Tr. 1191-1192). On cross-examination, Mr. Farrell construed as an act of discourtesy the imposition upon

e the of LATD's staff, but testified that the Commission's staff ere very courteous, and there would be no complaints as to their nduct while on our premises" (Tr. 1238-1239).

The following is quoted from an affidavit of R. W. Rheinschild (10), who supervised the inspection by the Commission's staff:

> "14. In summary, access to the books and records of account of LATD was limited to fragmentary and incomplete records; those records vital to a determination of the true financial condition of LATD at any given date were withheld or refused; necessary control over accounts during the inspection was not allowed; LATD's financial and accounting officers were not allowed to explain the complex and confusing system of accounting, or to explain the procedures established for internal accounting control.
>
> "15. Throughout the inspection there were unnecessary delays in the submission of records which were made available, and it was necessary to conduct the limited and fragmentary inspection which was allowed under the most adverse and discouraging circumstances."

2. The Rule 37(b) Order. It was in this setting and after e Cmmission had filed and served a written demand that LATD and vidFarrell and all other officers and managing agents of LATD eas and desist from further preventing, obstructing or interring with the inspection" of LATD's records which the Comssin's staff was attempting to accomplish, in accordance with e order of the District Court (CR 140), that on September 3, 1959, e Commission applied to the District Court for an order for nctions under Rule 37(b). On October 5, 1959, following a hearing September 15, 1959, at which the contumacious conduct of LATD

and David Farrell in disobeying, on advice of counsel, the access order under Rule 34 was fully established (3 Tm 1-80), the District Court granted the Commission's motion under Rule 37(b) for an order, inter alia, that certain facts claimed by the Commission as to LATD and David Farrell should be taken as established, refusing to allow those appellants to oppose certain designated claims, and striking their answer to the amended complaint. An order of the District Court entered on October 5, 1959, recited that the Commission's "motion is hereby granted and plaintiff is directed to lodge with the clerk a proposed formal order within 3 days." The definitive order was lodged on Friday, October 9, 1959, and on Monday, October 12, 1959, a superseding order correcting minor inaccuracies was lodged. The district judge signed the superseding order late Monday afternoon, October 12, 1959 (Tr. 293-294).

In the meantime on October 8, 1959, appellants had filed a notice of appeal as well as applications for writs of mandamus and prohibition in this Court and a motion for stay pending the appeal. Appellants had not suggested to the District Court that the interlocutory order under Rule 37(b) should be ameliorated, although the district judge had expressly reserved jurisdiction to do so. On October 16, 1959, this Court denied the petition for prohibition or mandamus and dismissed, sua sponte, the "purported appeal" as not being within either 28 U.S.C. 1291 or 28 U.S.C. 1292.

Immediately thereafter, this Commission lodged with the District urta proposed order modifying, nunc pro tunc, the order under le 7(b). The appellants moved to vacate the entire order. The mmision opposed the motion to vacate, but the district judge, Ocober 23, 1959, ruled that the necessity for full disclosure al facts relevant to a determination of the issues, through gul:r and ordinary trial processes, overshadowed the need to ifor:e sanctions which the conduct of the appellants LATD and ivicFarrell so richly warranted. Accordingly, the district judge icat:d the order under Rule 37(b), although he observed that in s oinion, the appellants LATD and David Farrell were not de- rvig of the leniency which he was extending to them (Securities d Echange Commission v. Los Angeles Trust Deed & Mortgage Exchange, F...D. 460).

In view of the vacation of the order under Rule 37(b), titoner's argument that it was improperly entered becomes

irrelevant.[1/] The assertion of counsel for appellants that they were reduced to the role of "mere spectators" (LG 54) and "gagged" (DG 43) while the order was in effect is untenable. The facts are to the contrary. The trial was begun on Tuesday, October 6, 1959, the day after the District Court granted the Commission's motion but prior to the definitive order of October 12, 1959. The trial continued through October 7 and 8, 1959. On that day the notice of appeal and petition for writs of prohibition and mandamus were filed and no further evidence was taken in the District Court until after this Court had acted, nor until the District Court had vacated its order under Rule 37(b). During the three days of trial

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1/ We note, however, that appellants' statement that the "court received no evidence except the affidavit of an SEC investigator presented as part of the motion, and a verified response filed on behalf of the appellants" at the hearing on the Commission's motion for sanctions under Rule 37(b) (LG 45) is misleading. In addition to the detailed and documented twenty-page affidavit dated September 8, 1959 (PX 170) of R. W. Rheinschild of the Commission's staff, under whose immediate supervision the Commission's accounting investigation of LATD was conducted, there was incorporated by reference therein his earlier twelve-page affidavit of June 8, 1959, that had previously been filed in the Court (CR 76). Also, the affidavit of the head of the Commission's Los Angeles Office, Mr. Burr, had been submitted previously in opposition to David Farrell's motion to limit his examination by deposition (CR 76). Messrs. Rheinschild and Burr were in attendance throughout the hearing on the Rule 37(b) motion, but counsel for appellants did not avail themselves of an invitation of Commission counsel to cross-examine them (2 Tm 37-38). The district judge also had before him a schedule, appended to the Commission's verified motion under Rule 37(b) (CR 142), listing the records which had been made available and the records which had been refused, together with the reason given by counsel for appellants for the refusal. The contemptuous conduct of the appellants LATD and David Farrell was argued at length before the district judge (2 Tm 4-79) in the course of a hearing at which counsel for the Commission introduced four exhibits, including a number of written requisitions for records of LATD upon which counsel for appellants had endorsed "refused".

or ıereto, there was not even a mention of the Court's deter-
atin with respect to the Commission's application under Rule
b). Examination of the record makes clear that counsel for
ellnts participated exactly as though the motion under Rule
b) ad not been made and imposed no limitation upon themselves
theconduct of the trial (Tr. 1-290).[1] Neither counsel for the
mision nor the district judge attempted to impose any stricture
contraint, even in the slightest degree, upon counsel, nor could
y hve done so, since counsel for LATD and counsel for David
rel each represented other appellants as to which the order
er ule 37(b) was not made applicable.

Th proceedings on October 6, 1959, when the trial was begun, we e devoted to (a) introductory statements, in which counsel fc TD&ME and David Farrell addressed the Court at some length (T. 4-32), outlining the basic theory of the defense, counsel fc the remaining appellants reserved an opening statement but adressed the Court, without interruption, on several matters dectly concerning LATD (Tr. 1-41), and (b) the testimony of apellant Stanley C. Marks, LATD's comptroller, as an adverse witness, which consisted in large measure of his submission uder subpoena of certain records of LATD and the marking of tose records for identification (Tr. 42-117). Counsel for apellants participated freely in the proceedings, and made nmerous objections, several of which were sustained (Tr. 42-110), icluding a claim of privilege on behalf of LATD (Tr. 60). The tial was resumed on October 7, 1959, with the examination of Sanley C. Marks (Tr. 121-148; 206-223), conducted under similar ccumstances, interrupted by the testimony of Mrs. Aidel Krenberg, an investor (Tr. 148-206), who was cross-examined at lngth by counsel for appellants. The proceedings on October 8, 159, were devoted to the testimony of James West, Jr., another ivestor (Tr. 227-290). The testimony of this witness was divided amost evenly between direct and cross-examination.

3. Appellants' Conduct during the Trial. As noted in the Findings (F 46 ll. 40-47):

> "3. It was not until the trial was begun that the SEC, through subpoenas duces tecum, was enabled to dredge the necessary evidence from the defendants' records, evidence which the defendants, if acting in good faith and in compliance with the discovery order under Rule 34, would have made available long before. The net effect of defendants' recalcitrance was to obstruct and impede orderly trial processes, to unnecessarily consume the time of both the Court and the SEC, and to create unwarranted, burdensome, and entirely unnecessary problems for the SEC in sustaining, as it did by irrefutable evidence, the burden of proof on the complex issues involved in this litigation."

By reason of appellants' failure to comply with the order under Rule 34 prior to the trial, it was necessary for much of the examination of LATD's finances to be conducted from the records subpoenaed at the trial. For example, facts to establish the insolvency of LATD as at March 31, 1959, were obtained through records subpoenaed at the trial. To have obtained and studied the records in order to make necessary adjustments with respect to a subsequent balance sheet, as appellants apparently suggest that the Commission should have done (LG 73; DG 41), would have unduly lengthened the already long proceedings in the court below.

At the trial appellants objected time and again to the introduction in evidence of books and records which they themselves kept. They also engaged in tactics intended to mislead the Court as to summaries made from such books and records which had already been received in evidence.

An instance of these tactics relates to a schedule (PX 77), com-
ed ntirely from the records of LATD, showing the withdrawal by LATD
n te accounts of investors of 43 notes, secured by deeds of trust
ate against Tract No. 3068 (Newport Riviera I and II), and appel-
ts' attempt secretly to appropriate "windfall" profits belonging to
stors after LATD had received notice that an escrow had been
ablshed under which the 43 trust deed notes were to be satisfied
ul in advance of maturity (F 35-36).

Counsel for the appellants sought to mislead the District
rt nto believing that Column No. 3 of the schedule, which showed
orginal cost to LATD of the 43 trust deeds, was inaccurate in
t i did not take into account a commission of $315 per trust
l, aid to one E. G. Eldred; this would have increased LATD's
t fom $2,345 to $2,660 per trust deed, with a corresponding
egte decrease in LATD's gross profit at the time the trust
ls ere introduced into the accounts of investors from $37,353 as
m y Column No. 8 of the schedule to $26,808. The schedule had
st een marked for identification on December 8, 1959, and copies
ed on counsel for appellants at that time (Tr. 1468). Never-
es, on April 26, 1960, counsel for TD&ME and David Farrell,
he frequently reminded this Court and the District Court that
s n accountant certified in a number of jurisdictions, in an
rt to discredit the schedule, introduced in evidence two can-
ed checks of LATD, payable to E. G. Eldred totaling $13,545
5; DX AD). Despite the fact that counsel for the Commission

stated that the schedule was correct and that LATD's record of disbursements would show that the commission of $315 per trust deed was included in the gross cost shown on the schedule (Tr. 2998-2999), the following day, using the two checks as a basis, under questioning by counsel for appellants, David Farrell testified that the "$315 paid to Mr. Eldred . . . would increase our cost from $2,345 to $2,660, which would make a tremendous difference in the computations of profit and other representations and characterizations made with this schedule" (PX 77). At this point counsel for the Commission renewed an earlier request that the record of disbursements showing the gross cost of acquisition of the 43 trust deeds be produced (Tr. 3184-3186). This record would have immediately settled the question.

The same demand was renewed the following day at the end of the Court session (Tr. 3351), and twice again the next day (Tr. 3365-3366; 3413). The record of disbursements was never produced. Counsel for the Commission then proceeded to establish by various records of LATD already in evidence, and through admissions made by David Farrell (Tr. 3419-3436), that the questioned Column No. 3 of the schedule included the commission paid to E. G. Eldred and was entirely accurate. Counsel for appellants then conceded that the schedule accurately reflected LATD's gross cost (Tr. 3429-3436). The only reasonable inference from the foregoing, as stated by counsel for the Commission at the time, is that there was a "deliberate effort to withhold from the Court the true facts . . . and a deliberate effort to cast doubt upon the authenticity of the schedule" (Tr. 3429).

3. The Material Received in Evidence Was Proper.

The evidence that appellants assert should be excluded (LG 23-33, DG 2-43) falls within one of seven categories:[1/] (1) evidence that the nsruments issued by appellants were investment contracts (F 45-46); (2) evidence that funds entrusted to LATD by investors were channeled nt a number of real estate speculations in which David Farrell had onealed "participations" (F 40-44);[2/] (3) evidence of the fact that LATD so ominated and controlled the accounts of investors that it could and did manipulate such accounts to deprive investors of sums due them upon iqidation of trust deed notes in advance of maturity, by surreptitiously itdrawing trust deeds from such accounts after the trustors had notiie LATD that they intended to liquidate their obligations in advance of aturity (F 35-37);[3/] (4) evidence of arrangements under which LATD

1/ See Appendix Re relevance for allocation of questioned exhibits among seven categories of evidence.

2/ Appellants' statement (DG 3) that this Commission has "acquiesced" in "this type of dual role of corporate officer" is based upon the fact that the Commission has required disclosure of such dual capacities in registration statements filed with it (Tr. 2530). Cf. Section 23 of the Securities Act which states:

> "Neither the fact that the registration statement for a security has been filed or is in effect nor the fact that a stop order is not in effect with respect thereto shall . . . be held to mean that the Commission has in any way passed upon the merits of, or given approval to, such security."

3/ By resorting to such practices, LATD, of course, deceived investors by concealing from them the fact that the trust deed notes were to be liquidated at full value in advance of maturity. The appellant Oliver J. Farrell admitted (Tr. 1146) that in the usual such situation LATD would not advise the investor of the impending "windfall profit." He also testified that he considered the practice as not unethical (Tr. 1143).

brought into inventory and introduced into the accounts of investors thousands of trust deed notes created in connection with projected subdivisions, with LATD withholding from the purchase price of such trust deeds, and commingling with its general funds, substantial sums intended to cover "scheduled improvements" and to service interest requirements and amortization of principal for specified periods of time (F 45);[1/] (5) evidence of the financial condition of LATD subsequent to October 8, 1958; (6) evidence of LATD's lack of adherence to its announced standards of appraisal and valuation of trust deeds; and (7) evidence of other fraud and deceit.

Appellants urge that this evidence is not relevant to the issues in the case, presumably, with respect to the second, third and fourth categories, because it is additional to the specific items of fraudulent misrepresentations and omissions charged in the amended complaint. The items in these categories, however, are all clearly relevant to the quest[ion] whether the appellants "unless enjoined" would "continue to engage" in t[he] fraudulent practices specified in detail in the amended complaint (R 27) and the items in all the categories are relevant to the need for a recei[ver]. Moreover, items in the second, third and fourth categories relate direct[ly] to the charge in Count II-4(1) of the amended complaint to the effect th[at] the appellants were omitting to state material facts with reference to t[he]

1/ The significance of such arrangements from the standpoint of the we[lfare] of investors is clearly set forth in the findings. Since the recei[ver]ship was established a number of petitions have been filed in the D[istrict] Court by subdividers who entered into such arrangements with LATD s[eeking] to impress a trust upon the funds held by the receiver, on the theo[ry that] otherwise "scheduled improvements" cannot be made and that investor[s will] suffer.

ackground, integrity and qualifications of the officers of and per-
nnel employed by" LATD (R 21-22, 24).[1] Items in the fourth category
e also appropriate to the question whether an investment contract is
volved, particularly in the light of this Court's suggestion as to
e necessity for determining the existence of a common enterprise.[2]

Appellants certainly cannot complain of surprise. Nearly all
th evidence to which they take exception was explicitly delineated
th sixty-two-page statement of facts claimed by the Commission,
nexd as Schedule B to the Commission's motion under Rule 37(b) of
e Fderal Rules of Civil Procedure (CR 142). The motion and the
nexd schedule were filed and served on September 2, 1959, more than
monh before the trial commenced. The facts set forth in the
hedle and annexed exhibits constituted a massive bill of particulars.

The appellants seem to contend that all of the evidence which the
strict Court received is either too old or too new. It is too old
it establishes some misrepresentation which has been slightly
difed or refined in the crucible of litigation. It is too new if
exposes appellants' basic scheme and the continuing course of fraud
d deceit characterizing the entire enterprise. The appellants
parently contend that the District Court should have excluded all
idence bearing upon the issues which involved occurrences subsequent

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/ Although this charge specifies details relating to the former comp-
troller of LATD, it is broad enough to include concealment with
respect to the background, integrity and qualifications of any of
LATD's officers.

/ Los Angeles Trust Deed and Mortgage Exchange v. Securities and
Exchange Commission, 264 F. 2d 199, 212.

to October 8, 1958, the date the amended complaint was filed, except in those instances where appellants believe there is some advantage to them in such evidence. For example, counsel for appellants point to the misleading financial statement of LATD as at September 25, 1959 (PX 42) as establishing solvency at that time, and suggest that this Court take judicial notice of the interim report of Arthur Young and Company, as at June 7, 1960, annexed to a petition by the receiver which this Court denied (DG 41). The Commission joins in the suggestion that the Court judicially notice the interim report of LATD's financial condition, but not for the reason that the accounting firm "found the assets as of the date the receiver took over. . . to greatly exceed the liabilities of the corporations in receivership" (DG 41), as represented by counsel for appellants, but because the interim report clearly points to the conclusion that a proper evaluation of assets, including inventory, and a determination of unrecorded liabilities, will show LATD and its wholly owned subsidiary TD&MM were insolvent at the time the receiver took over, a conclusion consistent with the finding of the District Court (F 25) that as at March 31, 1959, LATD was insolvent and that "it is a reasonable assumption from the evidence that such insolvency is a continuing condition."

Appellants' evidentiary contentions, moreover, must be viewed in the light of the fact that substantially all of the items it

jected to were taken from their own records. As the District Court

ate in its findings (F 46):

> "From the outset of the trial, counsel for the SEC made it clear that the case for the SEC would be constructed primarily from the internal records of the corporate defendants (including documentary evidence of the defendants' deceitful course of dealing with investors), and from the testimony of the individual defendants and executive employees of the corporate defendants, whom the SEC called as adverse witnesses."

All except nineteen of the instruments or groups of instruments mpising the 113 exhibits which appellants assert were received in idace erroneously (LG 23 Appendix I) were records of appellants, oduced by them in response to subpoenas duces tecum or pursuant to mands made in open court, or they constitute duplicates of appel-nts records which were identified as authentic by one or more of e appellants, or they were received in evidence without objection to authenticity. 1/

Of the nineteen exhibits not falling within the categories ecified, six are summaries compiled entirely from the records LATD, 2/ and five are summaries compiled from appellants' records d rom other unchallenged sources. 3/ The summaries were admitted

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Te following exhibits fall within one or more of the categories secified: PXs 5-14; 17-24; 35-36; 43C; 50-52; 59-59A (except two svings deposit passbooks evidencing withdrawals totaling $20,000 b James T. Penning, an investor, which the evidence shows was ivested with LATD); 80-82; 86-A, B, C; 87-88-89A-B-C; 91; 101A-B-C103; 105-115; 117; 119-130A; 132-132A-B-C-D-F-134; 136A-B-137; 11; 153-158; 167; 174-178; 180-181.

Ps 77, 78, 160, 166, 168, 179.

Ps 96-100 - Schedules showing ratios of first and second trust deds to valuation appraisals described in findings (F 12-13).

by stipulation, subject to the right of LATD to introduce supplementary evidence or evidence tending to establish that they were in error in any respect, or were admitted without objection as to accuracy and authenticity. Of the remaining eight exhibits, to which appellants object, seven fall within various other clearly admissible categories.[1/] The eighth was withdrawn.[2/]

The appellants introduced no evidence of any nature tending to vary, contradict or discredit the accuracy and authenticity of a single one of the 113 exhibits listed in Appendix I to appellants' brief.

C. Appellants Had Proper and Sufficient Notice of All Steps Taken.

The record shows no instance where the district judge was not solicitous of the convenience of counsel for appellants in arranging the date and time for hearings; or, indeed, where he did not grant every request of such counsel for continuances, including the request that the trial date, that had been set months earlier for June 9, 1959 be postponed.[3/] The record shows no instance where counsel for appellants objected to the date or time of any hearing on any motion or other proceeding before the District Court.

1/ PXs 93, 131, 131A, 135, 144, 150, 159. See Appendix Re Exhibits for a description of these exhibits.

2/ PX 152.

3/ Commission counsel was prepared to go ahead with the trial on that date (1 Tm. 3) and in discussions of settlement possibilities with counsel for appellants had made clear that the parties were "at no time near enough to agreement to justify postponement of the trial" (1 Tm. 17, 19). Nevertheless the trial was postponed to October 6, 1959, on representations of appellants' counsel that they were "not prepared for trial of this action" (1 Tm. 3).

. Motions Filed in Court.

Appellants point to the fact that motions of the Commission rvd and filed in open court on June 9, 1959, (1) opposing the taking depositions of two staff officials of its Los Angeles office and to as subpoenas duces tecum served upon them [1/] and (2) requiring pellants to produce books and records pursuant to Rule 34 [2/] were ar on the following day (LG 34-35, 48-49) but this was specifically red to by appellants' counsel. When the case was originally called r trial on June 9, 1959, these were two of a number of interrelated tions either pending or then filed and served in open court. The anscript shows the concurrence of counsel for appellants that these heard the following day as follows (1 Tm. 12):

> "Mr. Foley: Now, there are five or six motions before the court, maybe four, four [sic] or six, I don't know which, motions before the court, and I think your Honor's suggestion that we dispose of the motions tomorrow morning would be most practical."

ence, the assertion (LG 35) that "there was no waiver or stipulation hortening time" for hearing thereon is categorically untrue.

. Ex Parte Orders.

Appellants assert that the District Court "issued written orders" where "no notice of motion [was] given, no hearings conducted hereon and no evidence received by way of affidavit or otherwise to upport the said orders" (LG 12).

1/ s to the correctness of the District Court's decision in granting his motion, see page 30, supra.

2/ s to the correctness of the District Court's decision in granting his motion, see generally pages 66, 67, supra.

Counsel for the Commission obtained only two ex parte orders from the district judge. The first of these, dated June 12, 1959, was an order to show cause why the motion of the Commission pursuant to Rules 30(b) and 45 of the Federal Rules of Civil Procedure for an order that the depositions of certain of the Commission's staff officers in Washington, D. C. should not be taken and that subpoenas be directed to them be quashed, or, in the alternative, for a limitation order and an order arranging a new date, time and place for the taking of such depositions, and an order staying their taking pending determination of the motion. This order dated June 12, 1959 set the Commission's motion for hearing on June 22, 1959, when it was duly heard before the District Court. The motion might have been rendered moot if there had then been no stay. Moreover, appellants' counsel had conceded that "the same issue of law" was involved as had been involved in connection with the previous order relating to the depositions of Commission employees (1 Tm. 55).

The second ex parte order was an order shortening time for hearing on the Commission's motion to advance the date of further trial, which the district judge signed on March 21, 1960. Following a hearing on March 25, 1960, the district judge set April 14, 1960, as the date for further trial, in order to suit the convenience of counsel for appellants who had other commitments (Tr. 2351-2354).

3. The Rule 37(b) Order and Its Vacation.

The appellants complain (LG 50-51) that they were not given sufficient time within which to file objections to the order imposing sanctions under Rule 37(b), as lodged by the Commission on October 9,

er), nd a superseding order lodged on October 12, 1959. As we have
, owever (page 70 , supra), on October 8, 1959, appellants had
ead noticed an appeal from the order granting the Commission's motion
a earing had been set before this Court on October 14, 1959, on
ellnts' petition for extraordinary relief. In those circumstances,
dstrict judge was clearly warranted in entering the definitive
erso that it would be before this Court for consideration, since
sope of the order under Rule 37(b) was the main basis for
elants' abortive application to this Court.

The appellants even complain that, following denial of their
iton for writs of prohibition and mandamus, and after counsel
the Commission lodged an order intended to ameliorate nunc pro
ic he situation in which LATD and David Farrell found themselves
a esult of their disobedience of the access order under Rule 34,
dstrict judge held a hearing on October 22, 1959, to consider
thr the nunc pro tunc order should be entered (LG 51-52). The
or shows that written objections to the proposed order were filed
apellants and that counsel for appellants advised the district
gethat "the time element" occupied "just a minor place" in his
ecions (Tr. 328). In any event the facts are that the nunc pro
ic rder was never entered. On the contrary, the district judge
taned a motion to vacate the order under Rule 37(b) which appel-
tsfiled and argued on October 22, 1959. Thus, far from being
juiced by the hearing, the appellants LATD and David Farrell were
edof the sanctions which their earlier defiance of the order of
Dstrict Court had brought upon them.

4. The Time Schedule for Objections to the Proposed Findings.

Appellants give a wholly false impression as to their opportunit to file objections to proposed findings submitted by this Commission (LG 52-53). They imply that on May 4, 1960, the day after the completio of the trial, the District Court issued an order, without notice or hearing, setting forth the time for appellants to file objections to the proposed findings submitted by the Commission and that there was no hearing on the settlement thereof.

The facts are that on May 4, 1960, the district judge entered a brief memorandum of his "indicated judgment," which included a direction that counsel for the Commission lodge proposed findings and conclusions and final decree by May 11, 1960, at 10:00 a.m. On the morning of May 11, 1960, the district judge summoned all counsel to a hearing in open court at which time counsel for the Commission reported that the galley proofs of its proposed findings and conclusion which were to be lodged with the court and served on appellants would not be ready for about one hour. It was at this time, on May 11, in open court and in the presence of counsel for appellants and with their full approval that the time schedule for submission of objections and settlement of the findings was established (Tr. 3583-3595). This provided for objections to be filed within seven days — by May 18, 1960 -- although counsel for appellants had conceded that five days would have been legally sufficient (Tr. 3592). This schedule was

did in the "Order Establishing Time Schedule for Lodging and lement of Proposed Findings of Fact and Conclusions of Law and il Judgment" (CR 125) which was issued on that date — and not lay 4, 1960, as stated by appellants (LG 52).

The galley proofs of the proposed findings and conclusions lodged with the court and delivered to counsel for appellants :3 p.m. on May 11, 1960, who then waived "any further appearance re the court until the date set for settlement thereof" (Tr. 3596-3). The proposed final decree was lodged and served the following , also in accordance with the agreed time schedule. On May 17,), the Commission served on counsel for appellants corrected galley ofs of the findings and conclusions merely correcting certain ious typographical errors. On May 18, 1960, counsel for appellants ed their objections and exceptions, and on May 19, 1960, in ordance with the agreed time schedule, all counsel appeared before district judge in open court. At that time counsel for the mission lodged and served a brief supplement to the proposed findings conclusions consisting of the insertion of two lines and the ition of a single footnote (footnote 21) (Tr. 3602). Counsel for ellants made no objection to the supplement.

The district judge gave counsel for appellants every opportunity to submit and argue their objections and exceptions to the proposed findings and conclusions and final decree. They chose not to do so, but contented themselves with general statements to the effect that the proposed findings and conclusions "depart from the normal standards" and are contrary to the earlier opinion of this Court. They stated at the conclusion of the hearing (Tr. 3619-3620):

> "Mr. Foley: Perhaps your Honor is somewhat disappointed by us not having filed precise point by point, word by word proposed adjustments, but there are 50,000 words, and if there were in fact proposed findings, it would be simple enough to show how the facts are wrong, if in fact they are, but, where you are dealing with arguments with which this document is so replete, it is almost impossible, without completely revising it.
>
> "I think your Honor has set upon the appropriate solution of that, of taking the matter under submission and preparing that which is appropriate under the circumstances.
>
> * * *
>
> "Mr. Cuthbertson: We have had an opportunity to argue the facts and the law of the case and we have done so.
>
> * * *
>
> "Insofar as our objections and exceptions to the proposed findings, I submitted them in writing for the court's consideration, and there is nothing I care to add verbally at this time. I think the written objections will speak for themselves."

At the same hearing counsel for appellants filed a motion to stay the decree which the District Court had indicated would be entered and the Court announced that a stay would be granted (Tr. 3603-36().

In the light of the foregoing, it is clear that appellants' se:ion (LG 12) that they "have had no trial" for alleged failure th District Court to comply with the notice and other provisions th Federal Rules of Civil Procedure or of the local rules of the urt below are wholly unsupported by the record. It is also in con-ast to the following statement made by appellants' counsel at the nclsion of the trial:

> "Mr. Foley: May I personally state to the court that I am thoroughly sympathetic with the court's -- well, not sympathetic, I am mindful of the court's tolerance and patience throughout the entire proceeding, and it is in that spirit that the defense counsel agree that at this time the record is complete on all essential elements, and accordingly terminate the defense" (Tr. 3456).

he Findings and Decree Are in Satisfactory Form.

Appellants contend that the Findings of Fact and Conclusions La are not understandable (LG 21). We believe that this Court ll gree that they are set forth in an explicit and completely under-ancble manner. They constitute an elaborate opinion of the district dge compressing within reasonable dimensions the lengthy and complex al record. They were drafted by counsel for the Commission and erd by the trial judge, in consonance with Rule 52 of the Federal les of Civil Procedure, in order to set forth in unmistakable terms e fcts upon which the reasoned conclusions and final decree of the

District Court rest.[1/] While it is true that the several sections of the Findings of Fact and Conclusions of Law are not separately labeled as such, there can be no element of confusion or misunderstanding with respect to the facts as stated. As noted at page 55, supra, the truly singular fact is that appellants have been unable to point to a single instance in which the findings do not conform to the evidence.

The test is whether the findings are "so explicit as to give the appellate court a clear understanding of the basis of the trial court's decision, and to enable it to determine the ground on which the trial court reached its decision." Irish v. United States, 225 F. 2d 3, 8 (C.A. 9, 1955). And see Benroze Fabrics Company v. Rosenste, 183 F. 2d 355, 357 (C.A. 7, 1950):

> "It is immaterial that some of these findings appear in the conclusions of law, for their true nature is not determined by their labels."

In the absence of a showing of prejudice, this Court has held that it will not reverse a lower court decision on the ground that that court "should have made separate findings and conclusions instead of commingling the two in a written opinion." Walker v. Lightfoot, 124 F. 2d 3, 5 (1941).

1/ This Court stated in Simons v. Davidson Brick Company, 106 F. 2d 518 521 (1939):

> "The fact that opposing counsel has prepared and submitted findings of fact for the consideration of the trial judge, and that such findings of fact may have been adopted by the trial judge as his findings, in no way detracts from their legal force or effect."

See also O/Y Finlayson-Forssa A/B v. Pan Atlantic Steamship Corporation, 259 F. 2d 11, 18 (C.A. 5, 1958).

Appellants also contend that the decree does not specify the sor for its issuance, as required by Rule 65(d) of the Federal es of Civil Procedure (LG 75), but the decree points out that "the dere sustains the allegation of each Count of the Amended and plmental Complaint for Injunction and for Appointment of a eiver" (J 1, 11 26-27), which sets forth sufficiently the reasons is issuance within the meaning of the rule. Cf. Ross-Whitney poation v. Smith Kline & French Lab., 207 F. 2d 190, 198 (C.A. 9, 53)'

While we believe the decree is in all respects fully under-andble, as the Supreme Court said in Regal Knitwear v. National oorRelations Board, 324 U.S. 9, 15 (1945):

> "If defendants enter upon transactions which raise doubts as to the applicability of the injunction, they may petition the court granting it for a modification or construction of the order . . . courts would not be apt to withhold a clarification in the light of a concrete situation that left parties . . . in the dark as to their duty toward the court."

~~The appellants contend (LG Appendix VI; 55-58) that the fact at he findings of the District Court include, at times verbatim, bstantially the entire statement of facts encompassed within the de under Rule 37(b), in some unspecified manner demonstrates that~~

The appellants contend (LG Appendix VI; 55-58) that the fact that the findings of the District Court include, at times verbatim, substantially the entire statement of facts encompassed within the order under Rule 37(b), in some unspecified manner demonstrates that the findings are lacking in integrity and are not based upon the record before the District Court. The striking parallel between the facts as asserted by the Commission, in connection with its motion under Rule 37(b), and the facts as found by the District Court on the basis of the extensive trial record, establishes only that the Commission in its statement under Rule 37(b) correctly and accurately set forth the essential facts and subsequently proved those facts. In this connection it is significant that in seeking writs of mandamus and prohibition before this Court, including a command to the district judge to vacate the order under Rule 37(b), counsel for appellants then contended that the facts which the Commission claimed to be true, and which the findings of the District Court show were established by the evidence, were dispositive of the issues in this litigation.[1/]

1/ The combined brief of TD&ME and David Farrell filed in this Court in support of their petition for writs of prohibition and mandamus stated (p. 12):

> "3. In this case on the basis of the facts found by penal imposition under the guise of Rule 37(b), the trial is over, the judgment is complete and all that remains is the execution and enforcement of the relief demanded in connection therewith . . . ."

. pellants' Charges of Misconduct on the Part of Commission
ployees are Baseless.

] Mrs. Korenberg's Testimony.

Appellants assert that the testimony of Mrs. Aidel Korenberg
r. 48-206) establishes that the Commission's counsel was guilty of
hoting" misconduct and hypocrisy in first "coaching" and then
bmtting Mrs. Korenberg as a "surprise" witness to leave a totally
lse impression with the trial coart, and that it was only through
ood fortune and almost fantastic speed" that appellants were
ccssful in establishing that she was not an investor in any true
nse as she had deposited nothing with LATD except a worthless
ecl for $35,000 (DG 27-28). The record establishes the contrary.

Mrs. Korenberg testified that shortly after she had received
chck from the State of California for $69,000 for certain real
tae she had sold to the State, she received LATD's brochure.
in desirous of securing earnings of "a little better than 3%" on
r oney, she telephoned William F. Deinhard, whose business card
lenifying him as an "estate analyst" she had received with the bro-
ur, and asked him to call on her and explain how she could receive
"scured 10%." Mr. Deinhard visited her, and she exhibited to him
e arrant for $69,000 which she had received from the State of
liornia, and explained to him that if she should lose the money she
oud actually have to commit suicide because [she was] older and
oud not] work any longer." Mr. Deinhard assured her that "it is

very safe, as anything, as any bank, and that [i]n fact, it works like a bank," and that "[y]ou have nothing to do with mortgages. All you have to do is let us know if you should need it and we will send it to you within two to four days."

Mrs. Korenberg testified that Mr. Deinhard offered her a gift — the "best and nicest" radio available if she would invest under appellants' Secured 10% Earnings Program, that she gave him her check for $35,000, payable to LATD, and that he then promised her a $200 "outfit" if she would turn over the remainder of the $69,000 (Tr. 149-155). Mrs. Korenberg did not succumb to Mr. Deinhard's further blandishments.

Mrs. Korenberg then testified that after spending a sleepless night she went to her bank (Morris Plan) and reported what she had done to one of the officers who advised her to "go to the SEC and find out there"; that she did so and discovered that LATD was in litigation with the Commission, and that she thereupon telephoned Mr. Deinhard and informed him that she "was not going through with the deal [and was] not going to back [her] check" 1/ and requested that it be returned to her. Mrs. Korenberg testified that the check was never returned (Tr. 156-157, 167).

1/ Mrs. Korenberg gave the check to Mr. Deinhard on Friday, September 17 1959, intending to deposit the $69,000 State warrant the following Monday in order to cover the check (Tr. 154, 156, 170).

The check (DX A) was deposited by LATD and as Mrs. Korenberg, after discovering that LATD was in litigation with the Commission, did not deposit the State warrant to cover the withdrawal, the check, of course, was dishonored. It is ironic that counsel for a corporate "financial institution" with a long record of issuing checks against insufficient funds (F 24) should attempt to persuade this Court that Mrs. Korenberg in some manner imposed upon LATD in these circumstance

On cross-examination, Mrs. Korenberg testified that she had

en iterviewed by a Commission attorney in San Francisco and agreed

appear as a witness in the proceedings before the trial court in

Ageles (Tr. 87), that the Commission arranged for her trans-

tation from San Francisco to Los Angeles and that upon arriving

th courthouse she was introduced to several members of the Commis-

on' staff (Tr. 191). Mrs. Korenberg testified that no one on the

mision's staff suggested that she testify to anything except the

ue acts (Tr. 190).

Mrs. Korenberg's testimony was clear, forthright and remained

shaen on cross-examination. It is certainly true that a member of

e Commission's legal staff interviewed her before she was brought to

s Ageles as a witness, but that scarcely constitutes hypocrisy or

scoduct. Had this not been done, counsel would have been negligent.

2 <u>The Schedule of Trust Deeds</u>.

The statement to the effect that a schedule (PX 160) compiled

tirly from the records of LATD, showing the low quality of 148 trust

edswhich had been introduced into the accounts of investors, was

secupon an adverse selection of "troubled" trust deeds deliberately

de y members of the Commission's staff (LG 31-32) misstates the

coil. The record shows that the selection constituted a representa-

ve sampling of trust deeds from LATD's records and that only eight

thirty-four trust deeds which were then known to the staff to be

roubled" were included within the selection (Tr. 3466-3469; 3472-

78).

3. Other Charges.

Throughout these proceedings appellants' counsel have substituted slander for argument. For example, on June 9, 1959, counsel stated to the trial court (1 Tm. 55) that

> "the assistant general counsel of the SEC lied to the Ninth Circuit, and I want to be able to prove that point, and I can. He indicated that there were certain registrations of this type [whole mortgage notes], which do not exist, and the only way I can pin him down and drive him into a corner and make him eat his false representations which I have heard in this Court, too, by certain SEC counsel, is to get them to fail to produce the records which they . . .allege exist and continually allude to."

In the course of the appeal from the preliminary injunction, Commission counsel had advised the court that Mason Mortgage & Investment Corporation had registered certain securities with the Commission under the Securities Act, including an issue of investment contracts evidenced by whole mortgage notes. This statement was correct (see page 29, fn. 1, supra).

On October 22, 1959, on appellants' motion to vacate the order imposing sanctions under Rule 37(b) (Tr. 375), appellants' counsel stated that he could only conclude that the Commission's trial counsel, perhaps was "educated in Moscow" (Tr. 375).

T͗ere is No Merit to the Charges that the District Judge was B̶ased and Prejudiced.

Two of the three affidavits upon which appellants rely as
.dening disqualifying personal prejudice (LG 23) were before
.s Curt on October 14, 1959, on appellants' petition for writs of
ıhibtion and mandamus. This Court by order entered on October 16,
ı9, enied the petition for the reason that there was then "no
:ficent or adequate showing of personal bias or prejudice on
: pat of the [trial] judge . . . ." As to these, we merely note
ıt i has long been established that the "bias and prejudice which
ı beurged against a judge must be based upon something other than
.ing in the case." Berger v. United States, 255 U.S. 22, 31
ı21)

The only other affidavit urged as showing bias is the affi-
rit f David Farrell filed in this Court on July 12, 1960, and which
ı ordered sealed. The events alleged in this affidavit were never

suggested to the district judge as a basis for his disqualification. Instead appellants continued with the trial and did not raise any question of bias based thereon until after the District Court had decided the case against them.[1/] Such "an afterthought" should not be considered by an appellate court. Cf. Bethlehem Steel Company v. National Labor Relations Board, 120 F. 2d 641, 652 (C.A.D.C., 1951).

The conference in chambers referred to was held at the instance of counsel for the Commission, who sought to shorten the lengthy trial and conserve the time of the District Court

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1/ The conference in chambers referred to in this affidavit was held on April 21, 1960 (Tr. 2723 et seq.). Thereafter there were six sessions before the trial judge in open court before the trial was completed and the findings and final decree were settled on May 19, 1960. The conference in chambers was mentioned not a single time by counsel for appellants throughout those lengthy proceedings, nor was any suggestion made, directly or indirectly, that the trial judge had evidenced any disqualifying prejudice against counsel.

Nor did the appellants bring the incident to the attention of this Court on June 7, 1960, on their motion for a stay of the decree pending appeal, or on June 9, 1960, on their motion for clarification and interpretation of the order of this Court on the motion for a stay. It was not until July 5, 1960, after the receiver of LATD and TD&MM had discovered the deplorable condition with which he was confronted, and had brought that situation to the attention of this Court, that appellants, in a maneuver of desperation, renewed their demand for disqualification.

d tat of litigants and their counsel by bringing about a stipula-
on nder which it would be unnecessary to establish the foundation
idece for certain schedules (PX 96-100).[1] The conference was
ld n the thirty-first day of an exhausting trial, in which all
cep less than two days had been consumed in the examination, as
vere witnesses, of certain of the appellants and of officers
d eployees of the corporate appellants, and the introduction of
teral records of LATD, which had been extracted from such witnesses
supoena under the most discouraging and time-consuming circum-
ancs (see pages 74-82, supra). The attempted examination of these

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Tese schedules show the percentage ratios of balances due on a rpresentative number of second trust deeds which had been introdced into the accounts of investors, together with balances due on underlying first trust deeds held by building and loan associations, t valuation appraisals made by appraisers for the associations (12-13). The four schedules had been compiled entirely from the rcords of the associations and from LATD's internal records. Counsel fr the Commission had submitted the drafts of the schedules to ounsel for the appellants months before, and the definitive schedules hd been marked for identification and copies served on counsel for apellants on December 11, 1959 (Tr. 1807-1816). Counsel for the ommission had also offered for examination photocopies of the records of the associations which had been used in compiling the percentage atios shown in the schedules. Other records as to which counsel for he Commission sought agreement were tabulations of dishonored checks ased upon tabulations prepared by officers of four different banks here LATD maintained accounts (PX 60-63). These had been marked for dentification on November 17, 1959, and submitted to counsel for ppellants for verification, so that they might be received in vidence (Tr. 1121-1126).

nother schedule (PX 77) showed the wrongful manipulation of investors' ccounts to secretly appropriate "windfall profits" belonging to nvestors, which had been compiled in its entirety from the records of ATD (F 35-36), and which had been marked for identification on ecember 8, 1960, and submitted to counsel for verification (Tr. 1468-469).

hostile, evasive and untruthful witnesses by counsel for the Commission had been conducted by counsel for the Commission against an almost insurmountable burden of a constant stream of objections and observations by counsel for appellants entirely lacking any legal basis and intended to suggest the answers which counsel for appellants wished the witnesses to give (see e.g., LG App. IV). Under these circumstances the trial judge may have displayed an understandable displeasure when a stipulation could not be achieved to eliminate these obstructive tactics.[1/]

We do not concede the accuracy of the incident as set forth in the affidavit of David Farrell nor of the elaboration thereof in appellants' brief (LG 11). And we note that no affidavit was submitted by counsel, who were present at the conference. The fact that it has been enlarged out of all proportion is indicated by the failure of appellants to make any reference to the incident thereafter in open court (see page 98, supra), doubtless for the reason that the remarks of the trial court constituted a thoroughly deserved rebuke.

1/ See United States v. 16,000 Acres of Land, Etc., 49 F. Supp. 645, 650 (D. Kan. 1942):

> "Neither irritation upon the part of the judge nor comments upon the judicial tactics of a party or his counsel are sufficient to show personal prejudice, whether such comments be discreet or indiscreet."

Cf. also Scott v. Beams, 122 F. 2d 777, 787 789 (C.A. 10, 1941); and Price v. Johnston, 125 F. 2d 806, 811 (C.A. 9, 1942).

. TE RELIEF GRANTED BY THE DISTRICT COURT WAS APPROPRIATE.

A The Injunction Granted by the District Court was Proper.

1. The Need for Relief.

The appellants' disposition towards unlawful and deceitful iduc made imperative the decree of the court below, in order to estll and prevent a continuation of the sort of business which was errpted only when the receivership was established. Although from e t time there may have been minor changes in appellants' Secured Eanings Program, as we have seen (page 9 , supra), for the most t apellants' sales have continued without essential change and eed there is no evidence to indicate that there had been any dimi-ion thereof prior to the close of the trial. The investment contracts d b appellants have never been registered under the Securities Act hae appellants been registered as brokers or dealers under the uriies Exchange Act. With respect to the fraudulent statements util-d i their selling brochures, as stated by the District Court (F 33, 44-6), "since this litigation was begun, the defendants have made some inents in certain of the cruder misrepresentations running through elborate brochures describing the Secured 10% Earnings Program," but Ccrt found a substantial amount of fraud in appellants' sales tiring (F 33-35).

Under these circumstances it would have been an abuse of dis-tic for the court below to have declined to grant a decree enjoining ellnts from continued violations of the registration and anti-fraud

provisions of the Securities Act with which they had been charged. As the Supreme Court recently stated with respect to the violations of the anti-trust laws, "once a violation . . . has been established" there is an obligation on the courts "to protect the public from a continuation of the harmful and unlawful activities." United States v. Parke, Davis & Company, 362 U.S. 29, 48 (1960). The Court continued:

> "A trial court's wide discretion in fashioning remedies is not to be exercised to deny relief altogether by lightly inferring an abandonment of the unlawful activities from a cessation which seems timed to anticipate suit. See United States v. Oregon State Medical Society 343 U.S. 326, 333."

That Congress intended the investing public to have similar protection has been made clear on numerous occasions. See e.g., Securities and Exchange Commission v. Culpepper, 270 F. 2d 241, 249 (C.A. 2, 1959):

> "It is clear, from the plain language of the [Securities] Act, that the appellants' cessation of their illegal activities prior to the commencement of this action would not preclude the issuance of an injunction especially if brought about by a Commission investigation. * * * A contrary ruling would work havoc with the Act's policy of protecting the investing public." 1/

1/ See also Otis & Company v. Securities and Exchange Commission, 106 F. 2d 579 (C.A. 6, 1939); Securities and Exchange Commission v. Torr, 87 F. 2d 446 (C.A. 2, 1937); Securities and Exchange Commission v. Okin, 139 F. 2d 87 (C.A. 2, 1943); Securities and Exchange Commission v. Universal Service Association, 106 F. 2d 232, 239-240 (C.A. 7, 1939), certiorari denied, 308 U.S. 622 (1940); Securities and Exchange Commission v. Thomasson Panhandle Company, 145 F. 2d 408 (C.A. 10, 1944).

Thus, even if appellants, voluntarily and not under compulsion the decree of the court below, had gone out of business, an unction would not be barred. There is always the possibility, if th likelihood, of reentry in the name of another. Securities Exhange Commission v. Culpepper, supra, 270 F. 2d at 250-251; her Manufacturing Company v. Myers Manufacturing Company, 242 U.S. (?16); Securities and Exchange Commission v. Lawson, 24 F. Supp. (I Md. 1938). See also United States v. Trans-Missouri Freight ociation, 166 U.S. 290 (1897); National Labor Relations Board Baltimore Transit Company, 140 F. 2d 51 (C.A. 4, 1944); cf. Shuck Securities and Exchange Commission, 264 F. 2d 358, 363 (C.A.D.C., 1958).

2. Scope of Injunction.

Appellants contend that the injunctive portion of the decree es beyond any possible violations which may be shown by the evidence" 7) because it purportedly enjoins appellants from dealing in "any ersecurities." Read in context, we believe that phrase in the re is modified by the subsequent language "created, issued or acquired sad defendants in connection with any investment plan, program or rangement heretofore designated by the defendants as a Secured 10% rnigs Program, Secured 10% Earnings Reinvestment Program or Secured % Ernings Accounts, or any similar plan, program or arrangement . . . sed upon the sale to members of the investing public of discounted ust deeds or mortgages covering residential or other real estate tuted within the State of California"(J 2, 11 27-31; J3, 11 1-3). No ecific objection to the scope of this portion of the final decree

was made to the District Court by appellants.[1] Should this Court believe, however, that the absence of a comma after the intervening words "including trust deed or mortgage notes or other evidences of indebtedness" (J 2, 11 26-27) would make the language susceptible to the interpretation claimed by appellants, we would have no objection to a direction that the decree be modified by the addition of such comma.

Read as we construe them, the findings fully conform to the tests in National Labor Relations Board v. Express Publishing Company, 312 U.S. 426 (1941), and May Department Stores v. National Labor Relations Board, 326 U.S. 376 (1945), relied upon by appellants. In the former case the court emphasized (312 U.S. at 435):

> "A federal court has broad power to restrain acts which are of the same type or class as unlawful acts which the court has found to have been committed or whose commission in the future, unless enjoined, may fairly be anticipated from the defendant's conduct in the past. * * * "

Cf. Federal Trade Commission v. Mandel Brothers, 359 U.S. 385, 392 (1959

1/ Cf. Seagram Distillers Corporation v. New Cut Rate Liquors, 221 F. 2d 815, 821, n. 3.

In Hillsborough Investment Corporation v. Securities and hane Commission, 276 F. 2d 665 (C.A. 1, 1960) the Court of Appeals irmd a decree enjoining the defendants from violating the istation requirements of the Securities Act in connection with y o the securities of " the issuer defendant. The Court noted t te inclusion of "any of the securities" of the issuer in the ree "might well be necessary to forestall further attempts by apellants to avoid the consequences" of their past violations 6 F 2d at 668).

Clearly a broad decree is necessary here. The appellants have own a singular lack of awareness of their unconscionable actions in nection with their obligations to investors under the Secured 10% nings Program. Should this Court free them from the restraints ose by the District Court, there is no question but that ellnts will again undertake, perhaps under a somewhat modified m, their course of fraud, deceit and disregard of the standards of duc that accepted business morals, as well as the federal securi-is laws, impose upon those who issue and deal in securities. This mad explicit in the testimony of David Farrell (Tr. 2297-2298) the effect that unless the District Court entered a decree of junction the enterprise would be continued exactly as it had been nducted in the past, and that nothing in the record evidenced the ighest fraud or wrongdoing.

B. The District Court Properly Appointed a Receiver.

1. The District Court had Jurisdiction to Appoint a Receiver.

As we have noted, Section 22(a) of the Securities Act and Section 27 of the Securities Exchange Act vest the United States district courts with jurisdiction over suits, such as the instant action brought by the Commission seeking a decree of the court enjoining violations of the respective acts. As an action in equity, such a suit makes available all of the inherent equitable powers of a district court in aid of the proper and complete exercise of its jurisdiction. Cf. Porter, Price Administrator v. Warner Holding Company, 328 U.S. 395, 398 (1946); Mitchell v. DeMario Jewelry, 361 U.S. 288, 291 (1960).

In Warner Holding Company, the Supreme Court held that a federal district court, in an action by the Price Administrator to enjoin violations of the Emergency Price Control Act of 1942, had the equitable power to order the restitution of rents collected in excess of the permissible maximum, even though there was no specific provision for restitution in the statute. In DeMario Jewelry, the Supreme Court held that in a suit by the Secretary of Labor to enjoin violations of the Fair Labor Standards Act, the federal district court could order reimbursement for losses of wages caused by a violation of that Act, even though there was no specific statutory provision for reimbursement.

In Deckert v. Independent Shares Corp., 311 U.S. 282 (1940), a private suit for an injunction, restitution and the appointment of a

:eier to enforce civil liability, which suit, like the instant case,

; gverned by Section 22(a) of the Securities Act, the Supreme Court

;crbed the scope of the equitable remedies available under that

:tin. The Court said (311 U.S. at 287):

> "* * * the Act as a whole indicates an intention to establish a statutory right which the litigant may enforce in designated courts by such legal or equitable actions or procedures as would normally be available to him.
>
> * * *
>
> If petitioners' bill states a cause of action when tested by the customary rules governing suits of such character, the Securities Act authorizes maintenance of the suit, providing the bill contains the allegations the act requires. That it does not authorize the bill in so many words is no more significant than the fact that it does not in terms authorize execution to issue on a judgment recovered under Section 12(2)."

Appellants seek to distinguish this case on the ground that it

s aprivate suit (LG 70, DG 38-39), but, as we have seen, both the

me Holding Company and DeMario Jewelry cases were brought by federal

ences and the jurisdictional provision in the latter case was essen-

al) the same as that here involved.[1/] Appellants confuse the

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[1/] Section 17 of the Fair Labor Standards Act, 29 U.S.C. 217, provides:

> "The district courts, together with the District Court for the Territory of Alaska, the United States District Court for the District of the Canal Zone, the District Court of the Virgin Islands and the District Court of Guam shall have jurisdiction, for cause shown, to restrain violations of section 15 of this title: Provided, That no court shall have jurisdiction, in any action brought by the Secretary of Labor to restrain such violations, to order the payment to employees of unpaid minimum wages or unpaid overtime compensation or an additional equal amount as liquidated damages in such action."

he Court noted in DeMario Jewelry that the 1949 amendments, which ided the proviso to this section, served only "to confirm the esult we reach independently of them" 361 U.S. at 296.

authorization to institute injunctive proceedings contained in Section 20(b) of the Securities Act and Section 21(e) of the Securities Exchang Act with the jurisdictional provisions of Section 22(a) of the Securiti Act and Section 27 of the Securities Exchange Act, and arrive at the erroneous conclusion that these latter sections cover only suits brougl by private litigants and not those instituted by the Commission (LG 69-0) But the sections on their face are clearly applicable to actions broug by the Commission. They refer to "all suits in equity and actions at law brought to enforce any liability or duty created" under the respec tive statutes. 1/

Indeed, when the public interest (here represented by the Commission) is involved, a district court's equitable powers broaden and are much more flexible than when a private controversy is at stake. Se Warner Holding Company, supra, 328 U.S. at 398; and see Virginian R. C. v. System Federation, 300 U.S. 515, 552 (1937). In the latter case th Court said:

> "Courts of equity may, and frequently do, go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are at stake." 2/

1/ Cases relied upon by appellants (LG Appendix XI; DG 37-38) to sho that the Commission is devoid of standing to seek a receivership re of no weight in the instant action. In the cases cited by appellnts there were no comparable statutory provisions and the courts were concerned with the foundation of their equity jurisdiction.

2/ Accord, Yakus v. United States, 321 U.S. 414, 441 (1944).

The breadth of a district court's equitable power to assist in enforcing a statutory policy in a suit by the agency entrusted with administering the statute is set forth in Warner Holding Company, supra, 328 U.S. at 398.

Te power to appoint a receiver to protect the interests of 'esors, like the power to order the restitution of excess rents and ;es is consistent with the foregoing principles. Accordingly, re- .ves have been appointed in those actions governed by Section 22(a) th Securities Act and Section 27 of the Securities Exchange Act where irt have found that the exercise of their equitable powers in the ersts of investors appropriately carried out the intent of the federal urties laws administered by the Commission. 1/

Se e.g., Securities and Exchange Commission v. Willcox (N.D. Ind., 135); Securities and Exchange Commission v. Colonial Trading Co., (.D. Nev., 1935); Securities and Exchange Commission v. Lubbe (S.D.Ill., 143); Securities and Exchange Commission v. Hempstead (D.C.R.I., 1944); Scurities and Exchange Commission v. Woodman (D. Mass. 1944); Securities ad Exchange Commission v. Adams, (N.D. Ill. 1949); Securities and Echange Commission v. Barrett Herrick & Co., (S.D.N.Y., Civil Action No. 12-396); Securities and Exchange Commission v. Zippin & Company (N.D. Il., No. 53C53); Securities and Exchange Commission v. Investment Bokers of New Jersey (N.J., 1960); Securities and Exchange Commission v Arthur C. Costello (E.D. Mo., 1960).

Se in addition Aldred Investment Trust v. Securities and Exchange Cmmission, 151 F. 2d 254 (C.A. 1, 1945), certiorari denied, 326 U.S. 75 (1946), an action under the Investment Company Act of 1940 in which he Commission sought and was granted both an injunction restraining the rectors of the investment company who were guilty of gross abuse of ust from continuing in their positions and the appointment of a re- eiver to reorganize or liquidate the company, and see Securities and kchange Commission v. Fiscal Fund Inc., 48 F. Supp. 712 (D. Del., 1943). though this Court has stated on the basis of the record before it on ppeal from the preliminary injunction therein that these two cases are ot controlling (264 F. 2d at 210-211), the reasoning as to the power f the court is nevertheless persuasive. In Aldred the Court held that here "the only effective means of protecting the interests" of investors as by a receivership, once the "equity power of the Federal Court" was alled into play, "its inherent powers where necessary to do justice and rant full relief", included the appointment of a receiver. 151 F. 2d t 260-261. Similarly, in Fiscal Funds the court noted that the power appoint a receiver is "an obvious corollary of the proposition that ice a court of equity has taken jurisdiction it may and should retain hat jurisdiction to do complete justice." 48 F. Supp. at 715.

Appellants' contentions that the Commission is not entitled by statute to seek the appointment of a receiver (DG 33-37 and LG Appendix XI), if accepted, would restrict, without a clear Congressional direction to do so, the arsenal of equitable powers traditionally inherent in the judiciary; for the power to appoint a receiver is an adjunct of the court's jurisdiction and not of the Commission's. Contentions similar to the appellants' were rejected in DeMario Jewelry, supra. The Court said (361 U.S. at 290):

> ". . . The court below took as the touchstone for decision the principle that to be upheld the jurisdiction here contested 'must be expressly conferred by an act of Congress or be necessarily implied from a congressional enactment,' 260 F. 2d at 933. In this the court was mistaken. The proper criterion is that laid down in Porter v. Warner Co., 328 U.S. 395." 1/

After quoting from the Warner Holding Company, the Court continued (361 U.S. at 291):

> "The applicability of this principle is not to be denied, either because the Court there considered a wartime statute or because, having set forth the governing inquiry, it went on to find in the language of the statute affirmative confirmation of the power to order reimbursement. Id., at 399. When Congress entrusts to an equity court the enforcement of prohibitions contained in

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1/ The Court foreshadowed this holding in Warner Holding Company, supra, 328 U.S. at 398:

> "Moreover, the comprehensiveness of this equitable jurisdiction is not to be denied or limited in the absence of a clear and valid legislative command. Unless a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied. 'The great principles of equity, securing complete justice, should not be yielded to light inferences, or doubtful construction.' Brown v. Swann, 10 Pet. 497, 503. See also Hecht Co. v. Bowles, supra, 330."

> a regulatory enactment, it must be taken to have acted cognizant of the historic power of equity to provide complete relief in the light of the statutory purposes. As this Court long ago recognized, 'there is inherent in the Courts of Equity a jurisdiction to . . . give effect to the policy of the legislature.'"

jrisdictional section at issue in DeMario Jewelry Company, Section of the Fair Labor Standards Act, 29 U.S.C. 217, does not contain the guage "or other order" which appellants contend (LG Appendix XI; 37 was the pivotal factor in Warner Holding Company.[1/]

This Court recognized the District Court's power to order a :eiership even as to a solvent corporation, in its opinion herein of ruary 17, 1960, when it said (264 F. 2d at 211):

> "We do not dispute the fact that it is within the well established power of the federal court, sitting as a court of equity, to order liquidation of a solvent corporation where there is no other course available to remedy a situation that needs solution. Riehle v. Margolies, 1929, 279 U.S. 218, 49 S. Ct. 310, 73 L. Ed. 669. And see Hornstein, a Remedy for Corporate Abuse, 40 Colum. L. Rev. 220, 224 (1940) . . . ."

Te Evidence Established that a Receivership was Required.

Although this Court held that a receivership was not appropriate th basis of the abbreviated record which was before it on the appeal om he preliminary injunction, the evidence uncovered in the trial of is ction fully supports[2/] the District Court's present findings (F 47)

1/ Se page 107, fn. 1, infra.

2/ Te test, of course, is whether the District Court abused its discretion by appointing a receiver in this action. Milwaukee & M.R. Compay v. Soutter, 154 U.S. 540 (1864). See 4 Pomeroy, Equity Jurisprudence (5th ed. 1941), Section 1331, p. 924.

that the appellants "knowingly have committed a series of indefensible breaches of trust in their administration of the Secured 10% Earnings Program, and . . . they are oblivious to the standards of conduct which applicable statutes and commercial honor demand"; that the appellants "have engaged in widespread and willful violations of the Securities Act and the Exchange Act, that there is no reasonable likelihood that they will discontinue such violations, even under a decree of injunction," and finally

> "that as at March 31, 1959, the defendant LATD was insolvent, in a bankruptcy sense, and that only through the interposition of a receiver will it be feasible, or indeed possible, to determine and adjust the equities of the thousands of investors whose savings have been entrusted to LATD, which are now seriously endangered."

The Court's ultimate finding was "that it is imperative that a receiver be appointed with instructions to secure an immediate accounting of the assets and liabilities of LATD and to proceed with an orderly liquidation . . . ."

Appellants' flippant characterization of these reasoned findings as "judicial double-talk" designed to conceal the inadequacy of the evidence (LG 71) is merely diversionary in the light of the detailed findings of the court below.

The fact that LATD is clearly insolvent in the bankruptcy sense is by itself adequate evidence of the necessity for a receivership to assure that all investors will be fairly treated <u>inter se</u>. As to LATD's

solency as at March 31, 1959, the District Court specifically

und (F 22):

> "The two accounting experts for the SEC, . . . have made a careful analysis of the financial condition of LATD as at March 31, 1959, and determined that on that date LATD was insolvent in a bankruptcy sense to the extent of $176,100. This determination was reached upon the basis of financial statements of LATD filed with its federal income tax return for the fiscal year ended March 31, 1959, an independent examination of the accounts of LATD as at that date, and three basic and necessary adjustments of the balance sheet. The insolvency of LATD, as determined by the SEC's accounting experts, and the nature of the adjustments made in the balance sheet, appear in an adjusted balance sheet as at March 31, 1959 (PX 168) . . ."

e he Appendix Re Adjusted Balance Sheet of LATD as at March 31, 1959,

ge 14.

The three adjustments resulted in a total charge to earned rplus of $276,100. The first adjustment removed an overvaluation of 7,55 from LATD's inventory of trust deed notes which resulted from TDs erroneous method of accounting for repurchased trust deeds. TDs inventory included trust deeds which had been repurchased from rjected by investors and these were stated at the offering price to vestors, which included LATD's margin of profit.[1/] The trust deeds

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he District Court set forth the following hypothetical example aken from the testimony of LATD's comptroller (F 22):

> "LATD purchases a trust deed note for inventory at an original cost of $600; the trust deed note is introduced into the account of an investor at a price to the investor of $1,100; shortly thereafter LATD repurchases the same trust deed note from the investor for $1,100; the repurchased note is then recorded on the books of account and valued in inventory at $1,100 rather than at the original cost to LATD of $600. This obviously results in an overstatement of inventory in the amount of $500."

which were repurchased from investors normally had become in default. Thus, contrary to sound accounting practice, LATD failed to eliminate from inventory a profit that had not been realized and might never be realized. Indeed, the sale of any of these trust deeds would likely have to be made at a loss (F 22, ll. 50 et seq.).

The second adjustment, amounting to a net charge to earned surp of $157,688 accounted for the profit lost by rescission of a transactio in which 800 identical trust deed notes, created against a tract known as Cimarron-Meadows, which were introduced into investors' accounts had to be returned to LATD's vendor because the sale violated state law. Although appellants claim (LG 33) that LATD did not sustain this loss u late June, 1959, the record clearly shows that the Commissioner of Corp- rations of the State of California issued a Desist and Refrain Order prohibiting the sale of the notes on February 9, 1959, and that genera y accepted accounting principles required recognition in the financial statement as at March 31, 1959, that the transaction would have to be rescinded (F 23, ll. 42-52).

The third adjustment removed from assets a "deferred promotion expense" of $50,000 relating to the 50,000 shares, $1 par value, issue to David Farrell for promotional services. On a test of solvency, sou accounting practice required elimination of this "asset" since it pro- vided no realizable value for relief to creditors (F 23. ll. 54 et se)

Appellants sought to establish a countervailing adjustment of $141,000 by treating as a "surplus reserve," what was reflected on the

derl income tax return, and several of their monthly balance sheets, a reserve for repurchases" and there treated as a deduction from venory. The District Court found, however, that "the 'reserve for purchases' [did] not meet any of [the] essential tests' of a surplus reve (F 24, 11. 834).

Appellants base their accounting contentions on the testimony an independent certified accountant, Edwin Russ (DG 41), with respect whose testimony the District Court stated (F 46-47):

> "The Court rejects the testimony of Mr. Russ, but in doing so notes that he was called upon by the defendants to testify in an area in which he admittedly had no special competence, and the record shows that, for some incomprehensible reason, information of vital bearing upon his testimony was withheld from him (Tr. pp. 3242-3686). The Court believes that, had the true facts been made available, Mr. Russ would not have consented to appear as a witness."

Appellants also criticize the use of March 31, 1959, as the e the Commission chose to compute LATD's financial condition. They nt to LATD's financial statement as at September 25, 1959, which ey assert shows LATD to be solvent, as a more current presentation 1). [1/] As this Court was aware in its prior opinion (264 F. 2d at 207),

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he Commission did not introduce this exhibit as an accurate presenation of LATD's accounts on September 25, 1959. The exhibit (PX 42) as introduced as evidence of LATD's "window-dressing" of its accounts F 25-26) and as a basis for an admission upon which a deficiency in ATD's "net capital" ratio on that date could be predicted (F 18). lthough appellants classify Robert F. Jordan, who certified the eptember 25, 1959, statement, as an "independent CPA" (DG 41), he was n fact a member of LATD's management. The District Court found his ertifications to LATD's financial statements, including that of eptember 25, 1959, to be "clearly lacking in integrity, and [constiuting] 'litigation certificates' rather than 'the disinterested and objective viewpoint' which is the touchstone of the value of a certifying ccountant. Montgomery's Auditing, 8th Ed. 1957, p. 24." (F 26).

a meaningful balance sheet of LATD's accounts must reflect an accurate valuation of LATD's inventory of trust deed notes.[1/] This is underscored by LATD's practice, described above, of carrying notes repurchas from customers at the selling price rather than at cost.

Just as the adjustment downward in inventory was necessary on March 31, 1959, so too a comparable adjustment would be necessary in connection with the financial statement on September 25, 1959, a date when defaulted trust deed notes represented 57% of inventory. For the Commission to have presented accurately LATD's inventory account on September 25, 1959, would have required an extensive examination of th entire inventory. Such an examination was not feasible in view of the circumstances detailed at pages 64-76, <u>supra</u>. The District Court fou that, in the absence of necessary clarifications, LATD's financial statement as at September 25, 1959, was "grossly misleading" (F 28).

1/ In this connection the District Court said (at page 22 of its fin[illegible]

> "The liquidity and solvency of LATD has depended at all times in substantial measure upon the value and marketability of its inventory of trust deed notes. LATD's inventory has included, at all times, delinquent and defaulted trust deed notes repurchased from investors at their cost (generally 25% higher than LATD's original cost). These delinquent trust deed notes are carried by LATD in inventory, without segregation, at the higher cost, which necessarily results in an overstatement of the inventory account. As at September 25, 1959, these defaulted obligations represented 57% of inventor"

In addition, the debit balances in accounts of investors, which L[illegible]D records as receivables, do not represent currently enforceable ob- gations of the investors. See pages 19-20 of the District Court' findings and the Report of Arthur Young & Company at pages 3-4.

LATD's poor financial condition over a long period of time was
so ·eflected by its failure to meet the net capital requirements of
is ;ommission applicable to securities brokers and dealers, despite its
ntınued representation to the effect that its financial liquidity was
igh:r than most banks, savings and loan associations and securities
okı:s." This rule generally requires brokers and dealers in securi-
es :o maintain a ratio of "aggregate indebtedness" to "net capital"
t ıceeding 2000 percentum.[1/] As noted by the District Court (F 17)
n omputing 'net capital,' as defined in the Rule, all fixed assets
d cher assets not readily convertible into cash are eliminated and
cuities held in inventory by the broker or dealer are written down by
ecified percentages" in order to insure liquidity.[2/] The Commission's
pets testified in effect that if the trust deeds held by LATD in the
ıvetory could be assumed to have an ascertainable market value (which
ıs ighly doubtful), it would be no more than contemporaneous cost,
ıd hat the specific percentage of write-down applicable under the Rule
tis type of security would have been 30% (Tr.2833). Applying this
orrıla, in only two out of sixteen months examined did LATD meet the
et apital requirements. Even giving full value to the inventory, which
s v have seen included defaulted trust deeds and an inflated cost price

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ıle 240.15c3-1(a), set forth in the Statutory Appendix, p. A8, <u>infra</u>.

:milar deductions are required by the major stock exchanges in
omputing required capital of members.

when repurchased from investors, on six of the sixteen dates LATD failed to meet the net capital requirements (F 18).

LATD's poor financial condition was also evidenced by its histor of issuing checks against "insufficient funds" (F 24-25).

That important and basic adjustments are required in LATD's accounts to arrive at an accurate presentation of its financial conditio is confirmed by the "Report on Status of Accounts at June 7, 1960" by Arthur Young & Company, prepared at the instance of the receiver. Appellants ask that this Court take judicial notice of this report, asserting that the accountants "found the assets . . . to greatly exceed the liabilities of the corporations in receivership" (DG 41). But the report noted that this excess did not reflect an "evaluation of assets at realizable value or [a] determination of unrecorded liabilities" (page 8). As to the realizable value of the trust deed notes, the repor states (at page 4):

"Sale of Trust Deeds

> Another source of cash would be the sale of the inventory of trust deed notes. However, as mentioned previously under the discussion of investors' credit balances, the quality of these deeds is such that it appears that considerably less than the book amount of $2,420,000 will be realized on their disposition."

LATD's insolvency was concealed from investors by various
isleading devices previously described. Although some investors did
eceive monthly checks purportedly representing their "10% earnings"
hese were often simply a return of their own capital or were paid out
f deposits received from subsequent investors. In the absence of a
holesale demand by investors for liquidation of their accounts, LATD
as able to sustain its facade of solvency by a continuous distribution
f assets. Understandably, in such a situation, the court below found
hat only through receivership could the equities of investors be deter-
ined and adequately protected.

We also regard the further findings of the District Court to the
ffect that "LATD has managed to survive only through the continuous and
ndiscriminate commingling, diversion and misapplication of funds en-
rused to it by investors" (F 22), that appellants have secretly manip-
lated the accounts of investors in order to appropriate profits right-
ull belonging to investors (F 35), that moneys entrusted to appellants
y investors have been "channeled into a variety of real estate specu-
ations in which David Farrell had [undisclosed] 'participations'."
(F 4), and that, in general, appellants' administration of the Secured
0% Earnings Program has been marked by an entire disregard of applicable
iduciary standards (F 44), as strongly buttressing the conclusion of
he court below that a receivership was essential, and, that indeed,
ndependently of the finding of insolvency, the situation exposed by
he record required the appointment of a receiver.

The appellants' entire lack of contrition, their insensitivity to their misconduct as exposed in a public trial, their continuation of their willful course of fraud and deceit even after these proceedings were brought, and their determination to follow their chartered course in the future, are compelling reasons requiring affirmance of the relief granted by the District Court, including the appointment of a receiver. Cf. Walling v. Helmerich & Payne, 323 U.S. 37, 43 (1944). The appellants' intransigent intention to continue their unlawful conduct, as shown by their course of business subsequent to the filing of the original complaint on March 24, 1958, and the amended complaint on October 8, 1958, fully warrants the finding of the District Court (F 47, ll. 37-38) that "there is no reasonable likelihood that they will discontinue such violations, even under a decree of injunction," and makes it imperative that this Court sustain the decree of the court below. The conduct which the Commission and the courts may anticipate from appellants in the future is clearly mirrored in their actions in the past.

CONCLUSION

For the foregoing reasons the judgment of the District Court

ou[illegible] be affirmed.

Respectfully submitted,

Thomas G. Meeker,
General Counsel

David Ferber,
Assistant General Counsel

John A. Dudley,
Attorney

Securities and Exchange Commission
Washington 25, D. C.

E Kennamer, Jr.,
Chief Enforcement Attorney
Sa Francisco Regional
Office

Securities and Exchange
Commission
8[illegible] Market Street
Sa Francisco 3, California

ptember 1960.

A P P E N D I X

STATUTORY APPENDIX

SECURITIES ACT OF 1933

n At to provide full and fair disclosure of the character of securities
l ir interstate and foreign commerce and through the mails, and to prevent
ids n the sale thereof, and for other purposes.

ection 1. This act may be cited as
Secrities Act of 1933.

. When used in this title, unless the con-
othr wise requires—
) t term "security" means any note, stock,
ury stock, bond, debenture, evidence of in-
dnss, certificate of interest or participation
ny rofit-sharing agreement, collateral-trust
tice, preorganization certificate or subscrip-
, trasferable share, investment contract, vot-
trus certificate, certificate of deposit for a
rity fractional undivided interest in oil, gas,
the mineral rights, or, in general, any interest
n trment commonly known as a "security,"
ny ertificate of interest or participation in,
por y or interim certificate for, receipt for,
ran e of, or warrant or right to subscribe to
urcase, any of the foregoing. 1/

*   *   *

. 3. (a) Except as hereinafter expressly pro-
, th provisions of this title shall not apply
of he following classes of securities:

*   *   *

) ny security which is a part of an issue
d ad sold only to persons resident within a
Ste or Territory, where the issuer of such
ty a person resident and doing business
, if a corporation, incorporated by and
bu ness within, such State or Territory. 2/

(b) The Commission may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed therein, add any class of securities to the securities exempted as provided in this section, if it finds that the enforcement of this title with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds $300,000. 3/

SEC. 4. The provisions of section 5 shall not apply to any of the following transactions:

(1) Transactions by any person other than an issuer, underwriter, or dealer; transactions by an issuer not involving any public offering; or transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter and transactions in a security as to which a registration statement has been filed taking place prior to the expiration of forty days after the effective date of such registration statement or prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter after such effective date, whichever is later (excluding in the computation of such forty days any time during which a stop order issued under

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1 U.S.C. § 77b(1), 48 Stat. 74.
1 U.S.C. § 77c(a)(11), 48 Stat. 906 as amended 68 Stat. 684.
1 U.S.C. § 77c(b), 48 Stat.76.

section 8 is in effect as to the security), and except transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter. 4/

* * *

Sec. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; [15] or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed [16] under this title, unless such prospectus meets the requirements of section 10; or

(2) to carry or to cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 10. 5/

* * *

Sec. 7. The registration statement, ing to a security other than a securit a foreign government, or political thereof, shall contain the information companied by the documents specified A,[17] and when relating to a security foreign government, or political thereof, shall contain the information companied by the documents, specifie ule B; except that the Commission or regulations provide that any such or document need not be included any class of issuers or securities if it requirement of such information or inapplicable to such class and that dis adequate for the protection of invest wise required to be included within tion statement. * * * Any such statement shall contain such other and be accompanied by such other d the Commission may by rules or re quire as being necessary or appropria lic interest or for the protection of in

4/ 15 U.S.C. 77d(1), 48 Stat. 906 as amended 68 Stat. 684.
5/ 15 U.S.C. § 77e, 48 Stat. 77.
6/ 15 U.S.C. § 77g, 48 Stat. 78-79.

rites Act of 1933

:c. 1. (a) Except to the extent otherwise per-
ed (required pursuant to this subsection or
ectins (c), (d), or (e)—

() a prospectus relating to a security other
tha a security issued by a foreign government
or plitical subdivision thereof, shall contain
theinformation contained in the registration
statment, but it need not include the docu-
meis referred to in paragraphs (28) to (32),
incisive, of Schedule A;

* * *

4) there may be omitted from any pros-
peus any of the information required under
thisubsection (a) which the Commission may
by ules or regulations designate as not being
nessary or appropriate in the public interest
or pr the protection of investors. 7/

* * *

) Ay prospectus shall contain such other in-
natin as the Commission may by rules or reg-
ons equire as being necessary or appropriate
e blic interest or for the protection of in-
rs. 8/

* * *

Sec. 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. 9/

* * *

(c) The exemptions provided in section 3 shall not apply to the provisions of this section. 10/

* * *

Sec. 20.

(b) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States, United States court of any Territory, or the United States District Court for the District of Columbia to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. * * * * 11/

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1 U.S.C. § 77j(a)(1) & (4), 68 Stat. 685.
1 U.S.C. § 77j(c), 68 Stat. 686.
1 U.S.C. § 77q(a), 48 Stat. 84-85.
1 U.S.C. § 77q(c), 48 Stat. 85.
1 U.S.C. § 77t(b), 48 Stat. 86.

Securities Act of 1933

SEC. 22. (a) The district courts of the United States, the United States courts of any Territory, and the United States District Court for the District of Columbia shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 225 and 347). * * * * 12/

SEC. 24. Any person who willfully violates any of the provisions of this title, or the rules and regulations promulgated by the Commission under authority thereof, or any person who willfully, in a registration statement filed under this title, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $5,000 or imprisoned not more than five years, or both. 13/

REGULATION A-R--EXEMPTION OF FIRST LIEN NOTES

Rule 230 Securities Exempt

Promissory notes secured by a fi[rst] lie[n] ... estate upon which is located a dw[elli]ng ... residential or commercial propert[y] [s]hal[l] ... empt from registration under the Ac[t i]f su[ch] ... are offered in accordance with the t[erms a]ns[d con]ditions of this regulation.

Rule 231 Amount of Securities E[xem]pt

Neither the aggregate unpaid pri[nci]pal ... of the notes secured by the lien ... an[y] property nor the aggregate amount ... wh[ich] notes are offered to the public ... [sh]all ... $100,000.

Rule 232 Limitation Upon Aggr[eg]ate ... edness

The aggregate unpaid principal [am]ount ... indebtedness secured by all liens ... any property shall not exceed 75 perc[en]t of ... praised value of such property.

Rule 233 Limitations Upon No[tes] To ... fered

(*a*) The principal amount of e[ach] no[te] offered under this regulation shall ... be ... $500, and the total number of note[s] on a[ny] property shall not exceed 125.

(*b*) The notes shall be sold fo[r] cash ... chasers' obligations to pay cash [wi]thin ... after sale. 14/

12/ 15 U.S.C. § 77v(a), 48 Stat. 86-87

13/ 15 U.S.C. § 77x, 48 Stat. 87

14/ 17 C.F.R. § 230.230-233

SECURITIES EXCHANGE ACT OF 1934

Act to provide for the regulation of securities exchanges and of over-
ounter markets operating in interstate and foreign commerce and through
ails, to prevent inequitable and unfair practices on such exchanges and
ts and for other purposes.

ction 1. This act may be cited as
"Securities Exchange Act of 1934."

* * *

3. (a) When used in this title, unless
nte otherwise requires—

Th term "exchange" means any organiza-
ation, or group of persons, whether in-
rat or unincorporated, which constitutes,
ain or provides a market place or facilities
ringing together purchasers and sellers of
ties or for otherwise performing with re-
to ecurities the functions commonly per-
d b a stock exchange as that term is gen-
understood, and includes the market place
the market facilities maintained by such
nge 15/

* * *

Th term "broker" means any person en-
in he business of effecting transactions in
ties for the account of others, but does not
e a bank.

Th term "dealer" means any person en-
in he business of buying and selling securi-
or is own account, through a broker or
wise but does not include a bank, or any
in sofar as he buys or sells securities for his
ccount, either individually or in some fiduci-
apacity, but not as a part of a regular busi-

1/

* * *

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited. 17/

* * *

SECTION 15. (a) No broker or dealer (other than one whose business is exclusively intrastate) shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, unless such broker or dealer is registered in accordance with subsection (b) of this section. 18/

* * *

U.S.C. § 78c(a)(1), 48 Stat. 882.
U.S.C. § 78c(a)(4) & (5), 48 Stat. 883.
U.S.C. § 78c(a)(10), 48 Stat. 883-884.
U.S.C. § 78o(a), 49 Stat. 1377

Securities Exchange Act of 1934

(c) (1) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this subsection, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

* * *

(3) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to the financial responsibility of brokers and dealers. 19/

* * *

SECTION 21.

* * *

(e) Whenever it shall appear to e C
sion that any person is engaged or ab t to
in any acts or practices which cons ute
constitute a violation of the provision f t
or of any rule or regulation thereun , it
its discretion bring an action in the p per
court of the United States, the Supr e C
the District of Columbia, or the U ited
courts of any Territory or other pl su
the jurisdiction of the United Sta , to
such acts or practices, and upon a pr er
a permanent or temporary injunctio or r
ing order shall be granted withou bon
Commission may transmit such evide e as
available concerning such acts or p ctic
Attorney General, who may, in his scre
stitute the necessary criminal proc din
this title. 20/

* * *

19/ 15 U.S.C. § 78o(c)(1) & (3), 52 Stat. 1075.

20/ 15 U.S.C. § 78u(e), 48 Stat. 900.

ies Exchange Act of 1934

ion of Offenses and Suits

TION 27. The district courts of ted States, the United States Court for the District of and the United States courts rritory or other place subject risdiction of the United States e exclusive jurisdiction of s of this title or the rules ations thereunder, and of all equity and actions at law o enforce any liability or ted by this title or the rules ations thereunder. Any criminal g may be brought in the district ny act or transaction con- the violation occurred. Any ction to enforce any liability reated by this title or rules ations thereunder, or enjoin tion of such title or rules and ations, may be brought in any such or in the district wherein the is found or is an inhabitant acts business, and process in s may be served in any other of which the defendant is an t or whereever the defendant und. Judgments and decrees ed shall be subject to review ed in sections 128 and 240 of ial Code, as amended (U. S. C., secs. 225 and 347). No costs assessed for or against the on in any proceeding under this ught by or against it in the ourt or such other courts. 21/

Rule 15c1-2. Fraud and Misrepresentation.

(*a*) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15 (c) (1) of the Act, is hereby defined to include any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

(*b*) The term "manipulative, deceptive, or other fraudulent device or contrivance." as used in section 15 (c) (1) of the Act, is hereby defined to include any untrue statement of a material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading.

(*c*) The scope of this rule shall not be limited by any specific definitions of the term "manipulative, deceptive, or other fraudulent device or contrivance" contained in other rules adopted pursuant to section 15 (c) (1) of the Act. 22/

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15 U.S.C. § 78aa, 48 Stat. 902-903.

17 C.F.R. § 240.15c1-2.

Rule 15c3-1. Ratio of Aggregate Indebtedness to Net Capital.

(*a*) **General provision.**—No broker or dealer shall permit his aggregate indebtedness to all other persons to exceed 2,000 per centum of his net capital.

* * *

(*c*) **Definitions.**—For the purpose of this rule:

(1) The term "aggregate indebtedness" shall be deemed to mean the total money liabilities of a broker or dealer arising in connection with any transaction whatsoever, including, among other things: money borrowed; money payable against securities loaned and securities "failed to receive"; the market value of securities borrowed (except for delivery against customers' sales) to the extent to which no equivalent value is paid or credited; customers' free credit balances; credit balances in customers' accounts having short positions in securities; and equities in customers' commodities futures accounts; but excluding

(A) indebtedness adequately collateralized, as hereinafter defined, by securities or spot commodities owned by the broker or dealer;

(B) indebtedness to other brokers or dealers adequately collateralized, as hereinafter defined, by securities or spot commodities owned by the broker or dealer;

(C) amounts payable against securities loaned which securities are owned by the broker or dealer;

(D) amounts payable against securities failed to receive which securities were purchased for the account of, and have not been sold by, the broker or dealer;

(E) indebtedness adequately collateralized, as hereinafter defined, by exempted securities;

(F) amounts segregated in accord[...] Commodity Exchange Act and the r[...] ulations thereunder;

(G) fixed liabilities adequately se[...] estate or any other asset which is no[...] the computation of "net capital" [...] rule;

(H) liabilities on open contract[...] ments;

(I) indebtedness subordinated to [...] general creditors pursuant to a sati[...] ordination agreement, as hereinafte[...]

(2) The term "net capital" shall [...] mean the net worth of a broker or d[...] the excess of total assets over tot[...] adjusted by

(A) adding unrealized profits ([...] unrealized losses) in the accounts of [...] dealer and, if such broker or dealer [...] ship, adding equities (or deductin[...] accounts of partners, as hereinafter [...]

(B) deducting fixed assets and [...] cannot be readily converted into cas[...] debtedness secured thereby) incl[...] other things, real estate; furniture [...] exchange memberships; prepaid r[...] and expenses; good will; organiza[...] all unsecured advances and loans; [...] secured notes and accounts; and d[...] tomers' accounts, except in bona fide [...] within the meaning of section 4 (c) [...] T of the Board of Governors o[...] Reserve System;

(C) deducting the percentages s[...] of the market value of all securi[...] short (except exempted securities) [...] proprietary and other accounts of [...]

...ding securities loaned to the broker
...suant to a satisfactory subordination
... as hereinafter defined, and if such
...aler is a partnership, in the accounts
... as hereinafter defined:

... case of non-convertible debt securi-
... fixed interest rate and a fixed ma-
...hich are not in default, if the market
... more than 5% below the face value,
...n shall be 5% of such market value;
... value is more than 5% but not more
... low the face value, the deduction shall
...tage of market value, equal to the
... y which the market value is below
... ue; and if the market value is 30% or
... the face value, such deduction shall

... e case of cumulative, non-convertible
... ock ranking prior to all other classes
... of he same issuer, which is not in arrears
... ds, the deduction shall be 20%;

... ll other securities, the deduction shall
... ; 3/

/ 17 C.F.R. 240.15c3-1

APPENDIX RE COMPETENCY OF COMMISSION EXHIBITS

Exhibit No.	Description of Exhibit
PX 93	Certified Desist and Refrain Order dated February 9, 1959, issued by California Commissioner of Corporations to LATD, et al. re unlawful sale within State of California of 800 trust deed notes, which resulted in rescission and necessary adjustment of LATD's balance sheet as at March 31, 1959, as described in the finding of the court below (F 23).
PX 131	Copy of deed of trust dated June 15, 1959, securing blanket first lien in amount of $706,000, on a tract of land situated in Orange County, California, against whi[illegible] 431 second trust deeds of aggregate face value of $650,[illegible] were created and introduced into accounts of LATD's investors, without disclosure of the fact that the bla[illegible]et first trust deed contained no release clause, as descr[illegible]ed in the findings (F 34).
PX 131A	Copy of letter from Executors of Estate of Paul Hawkin[illegible] deceased, to Pinole Northridge, Inc., subdivider, desc[illegible]bing status of blanket first trust deed (PX 131). This let[illegible]r was received in evidence by tacit stipulation to the e[illegible]ect that, if called as witnesses, counsel for the Estate w[illegible]ld testify in accordance with the statements made therein

A11 and A12

Reversed

[illegible]

[illegible] [illegible]

[illegible] [illegible]

[illegible] [illegible]

Description of Exhibit

David Farrell testified (Tr. 2314) that "Mr. Pennington [was] in error . . ." and that "[h]is choice of language [was] most unpropitious and completely uncalled for."

Copy of letter dated December 8, 1959, received by David Farrell, evidencing Mr. Farrell's 50% stock interest in Globe Service Company and Aero Properties, Inc., two of LATD's principal sources of supply of trust deeds under the Secured 10% Earnings Program. The court below found (F 35 fn. 19) that ". . . the evidence strongly suggests, but does not fully establish that David Farrell had a 50% stock interest in [Aero Properties, Inc.]." The appellants introduced in evidence (DX AK) a photocopy of the original letter bearing a handwritten notation by David Farrell.

Brochure of Pacific Plan, one of LATD's competitors, tending to discredit appellants' claim that LATD was "America's Oldest and Largest." The findings of the court below (F 32) in this area, however, are supported without reference to PX 159, and are based entirely on LATD's records.

Exhibit No.	Description of Exhibit
	(i.e., that no modification of the blanket first trust deed had been accomplished) (Tr. 2780-2782).
PX 135	Certified copies of voluntary petition in bankruptcy filed by David Farrell, dated February 2, 1949, and discharge of bankrupt dated May 19, 1959, reflected in the findings (F 38).
PX 144	Letter dated October 19, 1959, from Ugene U. Blaloch, Vice-President and General Counsel of Forest Lawn Memorial Park, addressed to counsel for Commission, relating a telephone conversation with George W. Pennington, a salesman for LATD, who represented that "Trust Deed & Mortgage Exchange" was operated under "SEC supervision," and enclosing letter dated September 24, 1959, from Mr. Pennington representing that "our head counsel, Mr. Morgan Cuthbertson, has spent thirteen years of his life with the Securities and Exchange Commission, so we are virtually under 'S.E.C.' supervision . . .," as described in the findings (F 39-40). The letter from Mr. Blaloch was admitted pursuant to stipulation that, if called as a witness, he would testify in accordance with the statements made therein, subject to objection only as to relevancy and materiality (Tr. 2305-2314).

nstruments ssued as nvestment ontracts	Withholdings by LATD from vendors of trust deeds	Financial Condition of LATD	Secret "Participations" of David Farrell	Appraisals — Quality of trust deeds	Manipulation of investors' accounts	Fraud
X 5-14	PX 43C	PX 5-14	PX 78	PX 96-100	PX 77	PX 17-24
X 17-24	PX 52	PX 35-36	PX 89 A,B,C	PX 101 A,B,C	PX 80-82	PX 59-59 A
X 43C	PX 133-134	PX 43C	PX 93	PX 102-103	PX 86 A,B,C	PX 91
X 59-59A		PX 50-51	PX 113-115	PX 105-112	PX 87-88	PX 130-131A
X 77		PX 166	PX 117	PX 136 A,B	PX 179	PX 131
X 80-82		PX 167	PX 119-127	PX 137		PX 135
X 86 A-B-C		PX 168	PX 128-129	PX 160		PX 144
X 87-88			PX 150-151			PX 159
X 89 A,B,C			PX 153-157			PX 174-178
X 113-115						PX 180
X 117						PX 181
X 119-127						
X 130-131A						
X 132-132A-D, F						
X 133-134						
X 153-157						
X 158						
X 174-178						
X 180-181						

APPENDIX RE ADJUSTED BALANCE SHEET
LOS ANGELES TRUST DEED & MORTGAGE EXCHANGE
AS AT MARCH 31, 1959

Assets

Cash	$ 1,208,887.71
Advances to Customers	353,114.92
Inventory - Trust Deeds (Less Reserve)	1,524,562.31
Real Estate (Net) and Real Estate Contracts Receivable	248,224.13
Deposits with Escrow Companies	299,483.51
Notes and Accounts Receivable	18,702.23
Fixed Assets (Net)	52,056.77
Other Assets	8,700.02
Accounts Receivable (Goheen Construction Co.)	473,080.00
	$ 4,186,811.60

Liabilities and Capital

Accounts and Trust Deeds Payable	$ 1,335,960.54
Trust Funds - Board Trading	2,579.60
Customers' Accounts	2,434,343.44
Accounts Payable (Reversal of Goheen Sales)	570,072.00
Reserve for Real Estate Profits (Unearned)	19,956.27
Negative Net Worth	(176,100.25)
Total Liabilities and Capital	$ 4,186,811.60

APPENDIX RE FINDINGS OF FRAUD

AMENDED COMPLAINT COUNT II	FINDINGS	FINAL DECREE SECTION II
Paragraph	Section	Paragraph
2 a), b), c), d)	III B 8-12 IV B 1-5 IV C 1-6 XI A 1-3 XI C 1-5	A)a), b), c), l), p), q), u), w)
2 e)	X 1-2	A)f)
2 f)	III B 8 VII A 1-7 VII B 1-4 VII C 1-4; 21-22 XI A 1-3	A)e)
2 g)	XI A 4-6	A)h), t)
2 h)	III B 8-12 XI C 1-5	A)d)
2 i)	VI 1-4	A)i)
2 j)	X 1-2	A)g)
2 k)	V 1-6 XI A 6-8 XII A 1-5 XII B 1-16	A)j), v)
2 l)	VII E 1-6 XI A 3	A)k)
2 m)	III B 8 VII A 1-7 VII B 1-4 VII C 1-4; 21-22 XI C 1-5	A)m)

AMENDED COMPLAINT COUNT II	FINDINGS	FINAL DECREE SECTION II
Paragraph	Section	Paragraph
2 n)	IV A 1-2 V 1-4 XI A 6-8	A)n)
3	IV A 1-2 V 1-6 VII A 1-15 VII B 1-4 VII C 1-22 VII D 1-9 VII E 1-6 VII F 1-5	A)o), s), v); C)
4 a)	III B 1-12 III C 1-3 IV B 1-5 IV C 1-6 V 4 XI A 1-3	A)p), q), u); B)a)
4 b)	III B 8-12 IV B 1-5	B)b)
4 c)	XI A 4-6	B)c)
4 d)	VI 1-4	B)d)
4 e)	III B 8 XI B 1-12 XI C 1-5	B)e)
4 f)	IV A 1-2 V 1-6 XI A 6-8	B)f)